PRACTICE EXAM 10: ENROLLED AGENT PART 2 BUSINESSES SIMULATION (100 QUESTIONS)

This simulation mirrors the structure of the IRS Special Enrollment Examination, Part 2 - Businesses. It contains 100 multiple-choice questions with four answer options, weighted to the official domain proportions: 35 questions on Business Entities and Considerations, 44 on Business Tax Preparation, and 21 on Specialized Returns and Taxpayers. Allow 3 hours and 30 minutes. All questions relate to tax year 2025 and to the law as amended through December 31, 2025. The scaled passing score on the actual examination is 500 on a scale of 200 to 800. Answer every question; there is no penalty for a wrong answer.

1. Which entity is classified as a partnership by default with no election filed?

A. A domestic limited liability company having one member
B. A domestic limited liability company having four members
C. A corporation organized under a state incorporation statute
D. A foreign entity whose members all enjoy limited liability

2. Which change requires a business to obtain a new employer identification number?

A. A corporation electing to be taxed under Subchapter S
B. A partnership admitting several additional partners
C. A business changing its trade name and relocating premises
D. A sole proprietorship incorporating under state corporate law

3. Which period governs a Section 444 election's permitted deferral?

A. No more than six months measured from the required year end
B. No more than twelve months from the entity's formation date
C. No more than three months measured from the required year end
D. Any period the partners unanimously agree to adopt in writing

4. Which condition must hold for a qualified joint venture election?

A. The business must be unincorporated and both spouses must materially participate
B. The business must be organized as a limited liability company
C. One spouse must own at least seventy-five percent of the venture
D. The spouses must file separate returns for the taxable year

5. Which consequence follows a determination that an activity is a hobby?

A. Income is reported net of expenses up to the amount received
B. Income is excluded entirely where expenses exceed receipts
C. Expenses are deductible subject to a two percent floor
D. Income is reported in full with no deduction for related expenses

6. Which threshold applies to Form 1099-NEC for payments made during 2025?

A. Six hundred dollars per payee for the calendar year
B. Two thousand dollars per payee for the calendar year
C. Ten dollars per payee regardless of the payment type
D. Twenty thousand dollars and two hundred transactions

7. Which basis does a partner take in a partnership interest received for contributed property?

A. The fair market value of the interest received in the exchange
B. The partnership's inside basis in all of its underlying assets
C. The adjusted basis of the property contributed, a substituted basis
D. Zero until the partnership disposes of the contributed property

8. Which distribution may produce a deductible loss to a partner?

A. A current distribution of cash exceeding the partner's outside basis
B. A liquidating distribution of money, receivables, and inventory only
C. A liquidating distribution that includes a parcel of business land
D. A current distribution of appreciated operating equipment

9. Which item constitutes a hot asset under the partnership rules?

A. Cash held in the partnership's ordinary operating accounts
B. Land held by the partnership for long-term capital appreciation
C. Depreciation recapture potential embedded in partnership equipment
D. Marketable securities held as a long-term investment portfolio

10. Which event terminates a partnership under current law?

A. No part of any business continuing to be carried on in partnership form
B. A transfer of fifty percent or more of the interests within a year
C. The disposition of substantially all of the partnership's assets
D. The expiry of the term stated in the partnership agreement

11. Where are the cancellation of debt exclusions tested for a partnership?

A. At the partnership level before allocation to the partners
B. At whichever level produces the smaller taxable amount overall
C. At the partnership level for bankruptcy and partner level for insolvency
D. At the partner level, against each partner's own circumstances

12. Which condition must be satisfied for a partnership to elect out of the centralized audit regime?

A. The partnership must have fifty or fewer partners in total

B. Every partner must be an eligible type of person for the year
C. The partnership must obtain advance consent from the Service
D. The partnership must have existed for three or more years

13. Which requirement applies to the Section 351 control test?

A. Eighty percent of voting power and of each nonvoting class of shares
B. Eighty percent of the total value of all outstanding stock
C. Fifty-one percent of the total combined voting power alone
D. One hundred percent ownership by the transferring group

14. Which liability treatment applies where a shareholder borrows against property immediately before transferring it and retains the proceeds?

A. Only the excess of liabilities over basis produces gain
B. The liability reduces stock basis with no gain arising at all
C. The entire liability assumed is treated as boot received
D. The transaction fails Section 351 in its entirety

15. Which figure limits a corporation's charitable contribution deduction?

A. Fifty percent of adjusted gross income for the taxable year
B. Twenty-five percent of gross receipts from business operations
C. The full amount actually paid during the taxable year
D. Ten percent of taxable income computed before the deduction itself

16. Which item increases a corporation's earnings and profits?

A. Federal income taxes paid during the taxable year
B. Tax-exempt interest received on municipal bond holdings
C. Nondeductible fines assessed by a regulatory authority

D. Premiums on policies where the corporation is beneficiary

17. Which distribution tier reduces a shareholder's stock basis?

A. The tax-free return of capital following the dividend tier
B. The dividend to the extent of earnings and profits
C. The capital gain arising once basis has been exhausted
D. A distribution of appreciated property at fair market value

18. Which shareholder makes a corporation ineligible to elect S status?

A. An estate of a shareholder who died during the taxable year
B. A partnership holding a single share of the corporation's stock
C. A resident alien holding lawful permanent resident status
D. An electing small business trust holding a block of shares

19. Which stock difference creates a second class defeating an S election?

A. A difference in voting rights between two classes of common
B. A difference in transfer restrictions imposed by shareholder agreement
C. A difference in the par value assigned to the shares issued
D. A difference in rights to distribution and liquidation proceeds

20. Which item establishes debt basis for an S corporation shareholder?

A. A personal guarantee of a bank loan made to the corporation
B. Corporate borrowing from an unrelated commercial lender
C. A direct loan of funds from the shareholder to the corporation
D. Personal assets pledged as collateral for corporate borrowing

21. Which restoration ordering applies where an S corporation shareholder's bases were both reduced?

A. Stock basis is restored first because equity ranks ahead of debt
B. Debt basis is restored first, up to the amount previously reduced
C. Both are restored proportionately to their earlier reductions
D. Neither is restored once reduced in an earlier taxable year

22. Which item does not increase the accumulated adjustments account?

A. Ordinary business income allocated to the shareholders
B. Separately stated income items reported on Schedule K-1
C. Tax-exempt interest earned on municipal obligations held
D. Gain recognized on distributing appreciated corporate property

23. Which condition must exist for the built-in gains tax to apply?

A. The corporation must have a prior C corporation history
B. The corporation must have more than one hundred shareholders
C. The corporation must have distributed appreciated property
D. The corporation must have elected S status within five years

24. Which event terminates an S election on the exact date it occurs?

A. A revocation filed after the fifteenth day of the third month
B. A distribution exceeding the accumulated adjustments account
C. The corporation's failure to file a timely annual return
D. Issuance of a single share to an ineligible shareholder

25. Which trust may hold S corporation stock without defeating the election?

A. A qualified subchapter S trust that has made the required election
B. A foreign trust with beneficiaries resident in the United States
C. An irrevocable trust whose named beneficiary is a partnership
D. A charitable remainder unitrust holding the shares outright

26. Which figure limits an S corporation shareholder's deductible loss?

A. Stock basis alone, without regard to any loans made by the holder
B. Stock basis plus debt basis arising from direct shareholder loans
C. Stock basis plus the shareholder's share of all corporate debt
D. Stock basis plus amounts personally guaranteed by the shareholder

27. Which allocation method must an S corporation use?

A. Allocation according to each shareholder's adjusted stock basis
B. Special allocation where the economic effect is substantial
C. Strictly pro rata allocation computed per share and per day
D. Allocation as agreed among the shareholders in a written accord

28. Which corporation may never use the cash method of accounting?

A. A personal service corporation performing legal services
B. A farming corporation with modest annual gross receipts
C. A service business holding no inventories at any point
D. A tax shelter, regardless of the level of its gross receipts

29. Which item is subtracted from purchases in computing cost of goods sold?

A. Freight charges incurred in acquiring the merchandise
B. Merchandise withdrawn by the owner for personal use
C. Trade discounts allowed by suppliers on their invoices

D. Storage costs for goods awaiting eventual sale to buyers

30. Which requirement accompanies an election of the last-in, first-out inventory method?

A. The election must be renewed annually on each timely return
B. The method must be combined with lower of cost or market
C. The method must also be used in reports to creditors and owners
D. The method applies only to goods acquired after the election

31. Which cost must be capitalized into inventory under the uniform capitalization rules?

A. Distribution of completed goods to the purchasing customers
B. Advertising expenditures promoting the finished product line
C. Research and experimental costs for developing new products
D. Warehousing of finished goods still awaiting sale to customers

32. Which amount is excluded from a taxpayer's amount at risk?

A. Nonrecourse financing obtained for an equipment leasing activity
B. Cash contributed directly to the activity by the taxpayer
C. The adjusted basis of property contributed to the activity
D. Borrowed amounts for which the taxpayer is personally liable

33. Which discharge produces no cancellation of indebtedness income?

A. A lender reducing the principal on an operating credit line
B. A supplier writing off a trade payable owed by a customer
C. A creditor forgiving a portion of an equipment loan balance
D. A seller-financed purchase price reduction for a solvent buyer

34. Which attribute is reduced first following an excluded cancellation of debt?

A. Net operating loss carryovers available to the taxpayer
B. The basis of depreciable property held in the business
C. Capital loss carryovers from earlier taxable years
D. Foreign tax credit carryovers accumulated to that date

35. Which compensation risk arises in a closely held C corporation?

A. Understated amounts being recharacterized as taxable wages
B. All compensation becoming nondeductible where any excess exists
C. Excessive amounts being recharacterized as nondeductible dividends
D. Compensation being capitalized rather than deducted currently

36. Which family employment arrangement escapes Social Security and Medicare tax?

A. A spouse employed by the other spouse's sole proprietorship
B. A child aged sixteen employed by a parent's sole proprietorship
C. A parent employed by an adult child's sole proprietorship
D. A child aged twenty employed by a parent's proprietorship

37. Which travel expense is deductible where a domestic trip is primarily personal?

A. Round-trip transportation to and from the chosen destination
B. Lodging for the entire duration of the trip undertaken
C. Expenses at the destination directly attributable to business
D. Meals for every day of the trip at the fifty percent rate

38. Which expense produces no deduction whatever under current law?

A. Business meals with a client at a restaurant near the office
B. Entertainment such as tickets purchased for a client
C. Meals provided at a company-wide recreational gathering
D. Meals treated as compensation and included in employee wages

39. Which condition converts an accountable plan into a nonaccountable one?

A. Reimbursing employees more than once each calendar month
B. Requiring receipts for expenditures below a stated amount
C. Reimbursing meals at the fifty percent deductible rate
D. Permitting employees to retain unspent travel advances

40. Which figure caps the Section 179 deduction beyond its dollar limits?

A. Aggregate taxable income from the active conduct of any business
B. Gross receipts of the business for the taxable year in question
C. The taxpayer's adjusted gross income before the deduction
D. The total basis of all property placed in service that year

41. Which property is recovered over twenty-seven and a half years?

A. Nonresidential real property used in a trade or business
B. Residential rental property acquired for letting to tenants
C. Land improvements such as fencing and drainage tile
D. Qualified improvement property in a commercial building

42. Which gain is recaptured as ordinary income on the sale of business equipment?

A. Only depreciation claimed in excess of the straight line amount
B. Only the portion attributable to bonus depreciation claimed
C. All depreciation previously allowed or allowable on the asset

D. None, because equipment produces Section 1231 gain entirely

43. Which property still qualifies for like-kind exchange treatment?

A. Business equipment traded in on a replacement machine
B. A partnership interest exchanged for another such interest
C. Breeding livestock exchanged for animals of the same sex
D. Real property held for productive use in a trade or business

44. Which item is excluded from qualified business income?

A. Reasonable compensation paid to an S corporation shareholder
B. Ordinary income from a domestic manufacturing partnership
C. Rental income from a domestic trade or business activity
D. Section 179 expense allocated on the owner's Schedule K-1

45. Which business retains the qualified business income deduction at any income level?

A. A consulting practice advising corporate management clients
B. An engineering firm providing structural design services
C. An accounting firm preparing tax and audit engagements
D. A brokerage firm dealing in securities for its clients

46. Which carryover applies to a net operating loss arising after 2017?

A. Two-year carryback with a twenty-year carryforward as before
B. Five-year carryback available to corporate taxpayers only
C. Twenty-year carryforward expiring where not fully absorbed
D. Indefinite carryforward with no carryback except for farming losses

47. Which difference between book and taxable income never reverses?

A. An allowance for doubtful accounts recorded for book purposes
B. Accelerated depreciation exceeding the book depreciation figure
C. Federal income tax expense recorded on the corporate books
D. Warranty reserves accrued for financial reporting purposes

48. Which treatment applies to a positive Section 481(a) adjustment?

A. Recognition ratably over four years beginning with the change year
B. Recognition entirely in the taxable year the change occurs
C. Recognition over the remaining life of the affected property
D. Recognition only when the related property is disposed of

49. Which condition defeats statutory relief from worker reclassification liability?

A. Reliance on a long-standing practice in a significant industry segment
B. Reliance on a prior examination that raised no classification issue
C. Failure to file required information returns for the workers
D. Reliance on published judicial precedent covering similar workers

50. Which person may be assessed the trust fund recovery penalty?

A. Only the corporation that employed the workers in question
B. Only an officer owning a majority of the outstanding stock
C. Only the person formally designated treasurer in the bylaws
D. Any responsible person who wilfully failed to remit the taxes

51. Which record must be retained until the limitations period for the disposition year expires?

A. Payroll registers for employees who have since departed
B. Records establishing the basis of business property held
C. Bank statements supporting deposits made during the year
D. Copies of information returns furnished to contractors

52. Which expense category may not be substantiated by a reasonable estimate?

A. Travel, meals, gifts, and listed property expenditures
B. Utilities consumed at a business operating location
C. Ordinary office supplies purchased during the year
D. Wages paid to employees during the taxable year

53. Which entity form permits entity-level debt to support an owner's loss deduction?

A. A partnership, where liabilities increase each partner's outside basis
B. An S corporation, where guarantees establish shareholder basis
C. A C corporation, where losses flow through to its shareholders
D. A sole proprietorship, where the owner is personally liable

54. Which conversion triggers gain at both the entity and the owner levels?

A. A sole proprietorship incorporating under Section 351
B. A C corporation electing to be taxed under Subchapter S
C. A C corporation liquidating to move assets into a pass-through
D. A partnership incorporating and then electing S status

55. Which item must both parties report consistently on a business asset sale?

A. The employment status of workers transferring with the business
B. The allocation of purchase price across the defined asset classes
C. The accounting method the buyer intends to adopt afterward

D. The seller's remaining net operating loss carryforwards

56. Which item is recognized entirely in the year of an installment sale?

A. Capital gain attributable to the appreciated land element
B. Interest income accruing on the deferred payment balance
C. Gain deferred and reported as the payments are collected
D. Depreciation recapture income arising on the property sold

57. Which figure determines applicable large employer status?

A. Full-time employees counted on the final day of the current year
B. Full-time employees plus full-time equivalents in the preceding year
C. Total employees appearing on the payroll at any point in the year
D. Full-time employees averaged across the current calendar year

58. Which trust is disregarded for federal income tax purposes?

A. A complex trust accumulating income at the trustee's discretion
B. A simple trust distributing all of its income currently
C. An electing small business trust holding operating company shares
D. A grantor trust where the grantor retained a power to revoke

59. Which item is subtracted in computing distributable net income?

A. Capital gains allocable to corpus for the taxable year
B. The personal exemption allowed to the fiduciary entity
C. Tax-exempt income net of its allocable expenses incurred
D. The distribution deduction claimed for amounts paid out

60. Which beneficiary absorbs distributable net income before any other?

A. The remainder beneficiary succeeding to the trust corpus
B. The beneficiary receiving the largest total distribution for the year
C. The beneficiary entitled to income required to be distributed currently
D. The beneficiary who received a distribution earliest in the year

61. Which exemption amount applies to an estate?

A. Six hundred dollars for the taxable year in question
B. Three hundred dollars, matching the simple trust figure
C. One hundred dollars, matching the complex trust figure
D. No exemption is available to an estate at any point

62. Which fee survived the suspension of miscellaneous itemized deductions for a trust?

A. Investment advisory fees of a kind individuals commonly pay
B. Custodial charges on a conventional brokerage account held
C. Management fees on rental property held purely for investment
D. Fiduciary fees that would not have arisen but for the trust

63. Which test examines what an exempt organization actually does?

A. The organizational test applied to the governing document
B. The public support test applied to the sources of funding
C. The operational test requiring operation primarily for exempt purposes
D. The commensurate test applied to program expenditure levels

64. Which conduct defeats exemption absolutely with no threshold applied?

A. Conducting an unrelated trade or business on a regular basis
B. Any part of net earnings benefiting a private insider
C. Attempting to influence legislation to a limited degree
D. Accumulating income rather than granting it out currently

65. Which passive income is nevertheless taxable to an exempt organization?

A. Rents from real property subject to acquisition indebtedness
B. Dividends received on marketable equity securities held
C. Interest earned on the organization's operating reserves
D. Royalties received under a trademark licensing arrangement

66. Which consequence follows three consecutive years of failing to file the annual return?

A. A per-day penalty accruing until the delinquent returns are filed
B. Conversion of the organization to private foundation status
C. Automatic revocation of exemption by operation of law
D. A requirement to obtain a fresh determination letter only

67. Which retirement plan may be established after the tax year has closed?

A. A savings incentive match plan established by the first of October
B. A simplified employee pension, funded by the extended return due date
C. A profit sharing plan adopted before the close of the plan year
D. A defined benefit plan requiring actuarial certification first

68. Which figure precedes the rate conversion for a self-employed plan contribution?

A. Net profit before any adjustment whatever has been applied
B. Gross receipts before deducting any of the business expenses
C. Net profit reduced by the entire self-employment tax paid

D. Net profit reduced by the deductible half of self-employment tax

69. Which livestock requires a twenty-four month holding period for Section 1231 treatment?

A. Breeding hogs held in the farmer's productive herd
B. Cattle and horses held for breeding or dairy purposes
C. Sheep and goats held for breeding and wool production
D. Poultry raised for eventual sale to processing operations

70. Which farm deduction is limited to fifty percent of other deductible farm expenses?

A. Prepaid feed, seed, and fertilizer acquired ahead of the season
B. Soil and water conservation expenditures made on farmland
C. Veterinary services provided to productive breeding stock
D. Depreciation on machinery used in ordinary field operations

71. Which activity is not a rental activity under the passive loss rules?

A. A twelve-month residential lease to a single family tenant
B. A ground lease of undeveloped land running for twenty years
C. One where the average period of customer use is six days
D. A commercial lease carrying annual renewal options for the tenant

72. Which requirement accompanies the special rental real estate allowance?

A. Material participation exceeding five hundred hours annually
B. Qualification as a real estate professional for the taxable year
C. Ownership of the property for more than twenty-four months
D. Active participation together with at least ten percent ownership

73. Which expense is deducted last where the vacation home limitation applies?

A. Mortgage interest allocable to the rental use portion
B. Utilities and repairs allocable to the rental use portion
C. Depreciation allocable to the rental use of the property
D. Property taxes allocable to the rental use of the dwelling

74. Which item is rental income when the landlord receives it?

A. A refundable security deposit held pending the lease expiry
B. A tenant improvement funded by the tenant for its own use
C. The landlord's own outlay on maintaining the rented property
D. Expenses the tenant pays on the landlord's own behalf

75. Which disposition releases suspended passive losses in full?

A. A fully taxable disposition of the entire interest to an unrelated party
B. A gift of the whole interest to an adult child of the owner
C. A sale of half the interest to an unrelated third-party purchaser
D. A transfer of the interest to a corporation the owner controls

76. Which item does not increase the accumulated adjustments account?

A. Ordinary business income allocated to the shareholders
B. Tax-exempt interest earned on municipal obligations held
C. Separately stated income items reported on Schedule K-1
D. Gain recognized on distributing appreciated corporate property

77. Which entity may file an amended return with corrected owner statements?

A. A partnership subject to the centralized partnership audit regime
B. A partnership that has not validly elected out of that regime
C. An S corporation correcting an error on a previously filed return
D. A partnership furnishing more than one hundred Schedules K-1

78. Which figure caps the deduction for business interest where no exemption applies?

A. Fifty percent of the taxpayer's gross receipts for the year
B. Twenty percent of the taxpayer's qualified business income
C. The amount of interest actually paid rather than merely accrued
D. Business interest income plus thirty percent of adjusted taxable income

79. Where does a self-employed owner deduct their own retirement contribution?

A. As an adjustment to income on the front of the individual return
B. On the business schedule as an ordinary operating expense
C. On Schedule SE before computing the self-employment tax
D. As an itemized deduction on Schedule A of the return

80. Which requirement applies to the small employer health insurance credit?

A. Employment of at least twenty-five full-time equivalent workers
B. Payment of the entire premium cost for every covered employee
C. Availability across an unlimited number of consecutive years
D. Enrolment through the small business health options marketplace

81. Which statement about the sequence of loss limitations is correct?

A. Each limitation is tested against the originally allocated loss
B. Each hurdle is tested against the amount surviving the previous one
C. The passive activity rules are applied before the at-risk rules

D. The excess business loss cap is applied before the basis test

82. Which condition must be met for a family member to be a recognized partner where capital is material?

A. The member must contribute services of substantial value
B. The member must genuinely own a capital interest in the firm
C. The interest must have been acquired by purchase for cash
D. The member must have attained the age of majority locally

83. Which treatment applies to a purchase of a partnership interest between family members?

A. It is treated as a gift for family partnership purposes
B. It is respected as an arm's length sale in every circumstance
C. It terminates the partnership for federal income tax purposes
D. It requires the partnership to obtain a new identification number

84. Which item must be allocated before family partnership income is divided by capital?

A. A market rate of return on the capital each partner holds
B. An amount equal to the donee's proportionate distribution
C. Reasonable compensation for services the donor rendered
D. Any guaranteed payment the partners agreed among themselves

85. Which excise tax applies to private foundations but not to public charities?

A. A tax on income from unrelated business activities conducted
B. A tax on reasonable compensation paid to organization officers
C. A tax on contributions received from a single major donor
D. A tax on failure to distribute a minimum amount each year

86. Which element must be present for unrelated business taxable income to arise?

A. The activity must produce net income rather than a loss
B. The activity must involve sales of tangible merchandise
C. The activity must be regularly carried on by the organization
D. The activity must be conducted outside the organization's state

87. Which person is a disqualified person for prohibited transaction purposes?

A. An owner of fifty percent or more of the sponsoring employer
B. Any participant holding an account balance within the plan
C. Any beneficiary designated to receive benefits upon death
D. Any vendor supplying goods to the employer's own business

88. Which consequence follows a prohibited transaction involving an individual retirement arrangement?

A. An excise tax applies to the amount involved in the transaction
B. The entire account ceases to be an arrangement for that year
C. Contributions are suspended for the three following years
D. A penalty of ten percent of the account balance is imposed

89. Which replacement period applies to breeding livestock sold because of drought?

A. Two years from the close of the year the gain is realized
B. One year, matching the ordinary deferral election period
C. Three years, as with condemned business real property
D. Four years, extendable where drought persists across a region

90. Which taxpayer may elect farm income averaging?

A. A C corporation engaged in commercial crop production
B. An exempt organization operating an agricultural research program
C. An individual partner reporting farm income on a Schedule K-1
D. A trust holding farmland leased out to an operating tenant

91. Which condition must a real estate professional satisfy alongside the hours test?

A. Ownership of at least ten percent of each rental activity held
B. More than half of personal services in real property businesses
C. Active participation in management decisions during the year
D. Licensure as a real estate agent or broker within the state

92. Which use makes a dwelling a residence under the vacation home rules?

A. Personal use exceeding the greater of fourteen days or ten percent of rental days
B. Personal use of exactly fourteen days during the taxable year
C. Any personal use whatever during the taxable year in question
D. Personal use exceeding half the days the property was rented

93. Which allocation method does the Service apply to vacation home interest and taxes?

A. Allocation across all three hundred sixty-five days of the year
B. Allocation using the total days the property was actually used
C. Allocation by the relative fair rental value of each period
D. Allocation entirely to the rental use of the dwelling itself

94. Which statement about a Section 197 intangible is correct?

A. It is amortized over its stated contractual term where shorter

B. It is deducted in full in the year the intangible is acquired
C. It is amortized over fifteen years regardless of its actual life
D. It is recovered only upon disposition of the whole business

95. Which requirement applies where an organization conducts several unrelated businesses?

A. Each activity is computed separately with no cross-offsetting permitted
B. The activities are combined into a single aggregate computation
C. Only the most profitable activity need be reported at all
D. Losses may offset the organization's exempt function income

96. Which figure is used in the property limb of the wage and property limitation?

A. The adjusted basis of qualified property at the close of the year
B. The fair market value of qualified property at its acquisition
C. The accumulated depreciation claimed on qualified property
D. The unadjusted basis of qualified property immediately after acquisition

97. Which item is added back to book income on the reconciliation schedule?

A. Tax-exempt interest earned on municipal bond holdings
B. Life insurance proceeds received on a key employee policy
C. Excess of tax depreciation over the book depreciation figure
D. Nondeductible penalties recorded as expense on the books

98. Which schedule analyses unappropriated retained earnings?

A. Schedule L, presenting beginning and ending balance sheets
B. Schedule M-1, reconciling book income to taxable income
C. Schedule M-2, which must agree with the balance sheet equity
D. Schedule G, identifying substantial stock ownership interests

99. Which condition permits an organization to obtain retroactive recognition of exemption?

A. Filing the application within twenty-seven months of formation
B. Filing the application within twelve months of the first year end
C. Obtaining a private letter ruling before commencing operations
D. Demonstrating that no taxable income arose in the interim period

100. Which statement about the excess business loss limitation is correct?

A. The disallowed excess is permanently lost to the taxpayer
B. The disallowed excess becomes a net operating loss carryforward
C. It is tested before the basis and at-risk limitations apply
D. It applies to corporations and individuals on identical terms

Practice Exam 10: Answer Key and Explanations

1. B — A domestic eligible entity with two or more members defaults to partnership classification where no election is filed, and disregarded treatment reaches only single-member domestic entities. A state-law corporation is a per se corporation with no election available at all, and a foreign entity whose members all enjoy limited liability defaults instead to corporate treatment under the inverted foreign rules.

2. D — A new number is required only where a new entity comes into existence, which incorporation accomplishes because a corporation is a different taxpayer from the proprietor. An S election changes only how an existing corporation is taxed, and changes in partnership membership, trade name, or location all leave the same taxpayer in place throughout.

3. C — A Section 444 election permits a deferral period of no more than three months measured backward from the required year end, so an entity required to use December may elect September, October, or November. Partnerships and S corporations making the election must compute a required payment, while personal service corporations face a minimum distribution requirement instead.

4. A — The election requires an unincorporated business jointly owned and operated by a married couple who both materially participate and file jointly. It is generally unavailable where the business is a state-law entity such as a limited liability company, though separate guidance permits disregarded treatment for a spousal company in a community property state.

5. D — Hobby expenses produce no deduction whatever under current law, because the route through miscellaneous itemized deductions is suspended and that suspension has been made permanent. Income is reported in full as other income with no offset, no carryforward, and no reduction against the gross receipts of the activity itself. No offset against the gross receipts of the activity is permitted.

6. A — The threshold for nonemployee compensation remains six hundred dollars for the tested year. Recent legislation raised it to two thousand dollars, but only for payments made after December 31, 2025, which falls outside the year this examination tests. The twenty thousand dollar figure belongs to a different reporting regime entirely.

7. C — The contributing partner takes a substituted basis equal to the adjusted basis of the property contributed, and the partnership separately takes that same figure as a carryover basis in the asset received. Fair market value plays no role in either computation, and any appreciation is preserved rather than recognized on the transfer.

8. B — Loss may be recognized only on a liquidating distribution and only where the partner receives nothing but money, unrealized receivables, and inventory. A single item of other property absorbs the remaining basis and defeats recognition entirely, while cash exceeding basis in a current distribution produces gain rather than any deductible loss.

9. C — The definition of unrealized receivables reaches beyond conventional receivables to capture depreciation recapture potential embedded in depreciable property. A partnership holding heavily depreciated equipment therefore carries hot assets, and the portion of gain attributable to them becomes ordinary income rather than the capital gain a sale would otherwise produce. The distinction converts what looks like capital gain into ordinary income.

10. A — Termination now occurs only where no part of any business, financial operation, or venture continues to be carried on by any partner in a partnership. Technical termination on a fifty percent transfer has been repealed entirely, so ownership changes no longer close the tax year, restart depreciation, or require any short-period return.

11. D — Cancellation income flows through as a separately stated item and the bankruptcy, insolvency, and other exclusions are tested against each partner's own position. An insolvent partnership provides no relief to a solvent partner, so two partners receiving identical allocations from the same discharge can reach entirely opposite results. Two partners on identical facts can therefore reach opposite results.

12. B — Electing out requires both that the partnership furnish one hundred or fewer Schedules K-1 and that every partner be an eligible type. Trusts, partnerships, disregarded entities, and nominees are all ineligible, and a single ineligible partner defeats the election however small the partnership happens to be. The numerical threshold alone is never sufficient to permit the election.

13. A — Control requires at least eighty percent of the total combined voting power of all voting classes and at least eighty percent of the total number of shares of each other class. Both prongs must hold simultaneously, and the second is measured by share count within each class rather than by aggregate value.

14. C — Where the principal purpose of the assumption is avoidance of federal income tax, or there is no bona fide business purpose, the entire liability becomes boot rather than merely the excess over basis. Borrowing against unencumbered property shortly before transfer and pocketing the proceeds is the pattern this exception targets.

15. D — The limitation is ten percent of taxable income computed before the charitable deduction, before the dividends received deduction, and before any capital loss or net operating loss carryback. Excess contributions carry forward five years and are used after the current year's amounts in each later year. An accrual corporation may elect to deduct board-authorized amounts paid shortly afterward.

16. B — Tax-exempt interest is cash actually received and increases earnings and profits despite never entering taxable income, as do life insurance proceeds and the dividends received deduction. Federal income taxes, nondeductible fines, and life insurance premiums are all genuine outlays reducing the corporation's economic capacity to distribute. The measure exists to gauge real capacity to distribute rather than taxable income.

17. A — Only the second tier, the tax-free return of capital, reduces stock basis. The dividend tier does not touch basis at all, and the third tier arises only once basis has already been driven to zero. Reducing basis by the entire distribution produces a wrong figure offered among the answer choices.

18. B — Eligible shareholders are limited to individuals who are citizens or resident aliens, estates, certain qualifying trusts, and some exempt organizations. Partnerships and corporations may never hold shares, and a single ineligible shareholder terminates the election on the very day the disqualifying transfer occurs rather than at year end. Eligibility is continuous rather than tested once at the date of election.

19. D — The one class of stock requirement looks to identical rights in distribution and liquidation proceeds. Differences in voting rights are expressly permitted, which makes voting and nonvoting common the standard succession structure. Preferred stock carrying a priority dividend creates a second class and defeats the election immediately on issue. Straight debt within the safe harbor is respected as debt.

20. C — Debt basis arises only from a direct loan creating genuine indebtedness running from the corporation to that shareholder, which requires an actual economic outlay. A guarantee, a pledge of personal collateral, and corporate third-party borrowing all produce nothing until the shareholder actually pays under the obligation. Payment under the guarantee creates basis only at the moment it is made.

21. B — Losses reduce stock basis first and debt basis second, while restoration in a later profitable year runs in the opposite direction. A net increase rebuilds debt basis up to the amount previously reduced before any stock basis is restored, which protects the shareholder's loan ahead of the equity investment. Suspended losses become deductible again as that basis returns.

22. C — Tax-exempt income does not increase the account and its related expenses do not reduce it, though both items affect stock basis. Ordinary income, separately stated income, and recognized gains all increase it. Distributions reduce it only as far as zero, while losses may drive the balance negative. These two departures from ordinary basis mechanics are tested regularly.

23. A — The tax reaches only appreciation economically present at conversion from C to S status and disposed of within a five-year recognition period beginning on the first day of the first S year. A corporation that has always been an S corporation faces no exposure whatever the appreciation in its assets.

24. D — Where the corporation ceases to satisfy any eligibility requirement the election terminates immediately on the date of the disqualifying event. Issuing even one share to a partnership or nonresident alien accomplishes this, after which the year splits into an S short year and a C short year requiring separate returns.

25. A — Qualified subchapter S trusts and electing small business trusts exist precisely to hold S corporation stock, alongside grantor trusts, voting trusts, and certain testamentary trusts. Foreign trusts, trusts with ineligible beneficiaries, and charitable remainder trusts generally do not qualify, and a single ineligible holder terminates the election. A single ineligible holder terminates the election on that very day.

26. B — Losses are deductible to the extent of stock basis plus debt basis, and debt basis arises only from a direct loan to the corporation. Corporate borrowing from third parties, guarantees, and pledges of collateral all produce nothing until the shareholder actually pays under the obligation and becomes a creditor. Only an actual economic outlay by the shareholder will suffice here.

27. C — Allocation is strictly pro rata on a per share, per day basis, and special allocations are prohibited entirely. This is the sharpest structural contrast with partnerships. Where shares change hands mid-year, the annual total is divided by the number of days and each day's amount assigned to whoever held them.

28. D — Tax shelters may never use the cash method whatever their size, while personal service corporations, farming corporations meeting the applicable conditions, and service businesses without inventories may all use it where they fall below the gross receipts test governing the accrual requirement. The same threshold governs inventory accounting and capitalization alike.

29. B — Merchandise removed for personal use must be subtracted from purchases. Treating it as a business expense or ignoring it entirely overstates cost of goods sold and understates gross profit by the same figure. Freight is added to inventoriable cost, and trade discounts reduce the invoice price directly. The withdrawal is a personal item rather than any kind of business cost.

30. C — The conformity requirement obliges a taxpayer electing the method for tax purposes to use it in reports to shareholders, partners, and creditors, preventing the tax benefit being claimed while higher earnings are shown to a lender. The election applies until the Service consents to a change of method. Lower of cost or market may not be combined with it.

31. D — Storage and warehousing of goods before sale is an indirect cost requiring capitalization, along with purchasing, handling, quality control, production depreciation, and allocable overhead. Selling, advertising, distribution to customers, research and experimentation, and non-production administration all remain currently deductible period costs instead. The dividing line is whether goods await a buyer or move toward one.

32. A — Nonrecourse financing carries no personal liability and is excluded from amounts at risk, though it does increase basis under the liability rules. Qualified nonrecourse financing secured by real property is the narrow exception, and it is available only to real property activities rather than equipment ventures. Basis and at-risk amounts are computed from the same facts very differently.

33. D — A purchase price reduction agreed between the original seller and a solvent buyer not in bankruptcy is treated as a basis adjustment rather than income. Debt cancelled as a gift, contributed to capital, or representing an amount that would have been deductible if paid likewise produces no cancellation income. Only genuinely gratuitous discharge reaches the statutory exclusions at all.

34. A — The prescribed order runs net operating losses, general business credit carryovers, the minimum tax credit, capital loss carryovers, basis of property, passive activity carryovers, and finally foreign tax credits. The reduction equals the amount excluded rather than forgiven, and depreciable basis may be elected first instead. Both are reported on the prescribed form accompanying the return.

35. C — In a C corporation the danger runs toward compensation that is too high, since excessive amounts paid to a shareholder-employee become dividends, nondeductible by the corporation while remaining fully taxable to the recipient. The S corporation risk reverses entirely toward understated compensation being recharacterized as wages. Double taxation therefore falls on precisely the disallowed portion.

36. B — A child under eighteen employed by a parent's sole proprietorship, or by a partnership in which every partner is a parent, is exempt from Social Security and Medicare tax and stays exempt from unemployment tax until twenty-one. Spouses and parents remain subject to Social Security, and incorporating destroys every exemption.

37. C — Where a domestic trip is primarily personal, transportation to and from the destination is entirely nondeductible, but expenses at the destination directly attributable to business remain deductible. Where the trip is primarily for business, transportation becomes fully deductible even though some personal time is taken. Primarily business trips make the transportation fully deductible instead.

38. B — Entertainment produces no deduction at all regardless of business purpose, which captures tickets, club dues, and recreational outings. Business meals remain fifty percent deductible where the taxpayer or an employee is present, and food at an entertainment event is deductible only where separately stated on the invoice. Club dues and recreational outings are caught by the same prohibition.

39. D — An accountable plan requires a business connection, substantiation within a reasonable period, and return of any excess advance. Allowing employees to keep unspent advances defeats the third condition, and failure of any single condition converts the arrangement for every participant, making all payments taxable wages. Employee business deductions are suspended, so no offset survives.

40. A — The deduction cannot exceed aggregate taxable income from the active conduct of any trade or business, so it can never create or increase a loss, and disallowed amounts carry forward indefinitely. Bonus depreciation carries no comparable income limitation and can generate a net operating loss instead. Bonus depreciation carries no such ceiling and may create a loss.

41. B — Residential rental property carries a twenty-seven and a half year period while nonresidential real property runs thirty-nine years, both straight line under the mid-month convention. Land improvements run fifteen years, as does qualified improvement property, which is additionally eligible for Section 179 expensing unlike the building structure. Land is never depreciable and must be separated on acquisition.

42. C — Section 1245 recaptures all depreciation allowed or allowable as ordinary income before any Section 1231 treatment becomes available, so the ordinary component equals the lesser of depreciation claimed or total gain. Real property follows the gentler Section 1250 rule recapturing only amounts claimed above straight line. Under current recovery methods that usually amounts to nothing at all.

43. D — Section 1031 now applies exclusively to real property held for productive use in a trade or business or for investment, and real property is broadly like kind to other real property. Equipment, livestock, and partnership interests are excluded in every circumstance under current law without exception. Material describing equipment trade-ins reflects law repealed years ago.

44. A — Reasonable compensation is wages rather than qualified business income and is excluded, as are guaranteed payments to partners on the same reasoning. Capital gains, dividends, investment interest, and foreign income are also excluded, while ordinary income from a domestic trade or business remains firmly within the definition. Guaranteed payments to partners are excluded on identical reasoning.

45. B — Engineering and architecture are conspicuously absent from the statutory list despite appearing in comparable provisions elsewhere in the Code. Both retain the deduction at any income level, subject only to the wage and property limitations. Consulting, accounting, and brokerage all appear on the list and lose it. The wage and property limitations nevertheless continue to apply.

46. D — Losses arising after 2017 carry forward indefinitely with no carryback, except two years for farming losses, and the deduction in any year is capped at eighty percent of taxable income computed without the loss and without the qualified business income deduction. Pre-2018 losses are used first without limitation. Pre-2018 losses are used first and carry no percentage limitation.

47. C — Federal income tax reduces book income and is never deductible for tax, so the difference is permanent and changes the effective rate borne. Bad debt allowances, accelerated depreciation, and warranty reserves all reverse in later periods and are temporary differences affecting only when tax is paid. Permanent differences change the effective rate the corporation bears.

48. A — A positive adjustment increasing income spreads ratably over four years beginning with the year of change, while a negative adjustment decreasing income is taken entirely in that year. The asymmetry softens the cost of correcting a favourable but impermissible method and encourages voluntary rather than forced correction. Negative adjustments are instead taken entirely in the year of change.

49. C — Relief requires reasonable basis, substantive consistency, and reporting consistency, all holding at once. Failure to file information returns defeats the claim outright however reasonable the original basis was. Industry practice, a prior examination, and judicial precedent are each acceptable grounds for the reasonable basis element. All three conditions must hold simultaneously for relief to be available.

50. D — The penalty reaches any responsible person, meaning anyone with the authority and duty to direct payment, which can include officers, bookkeepers, and occasionally outside advisors. Wilfulness requires only knowledge that taxes were unpaid plus a decision to pay other creditors, with no intent to defraud needed. The liability survives dissolution and is not discharged in bankruptcy.

51. B — Basis records must survive as long as the asset does and then through the limitations period for the year of disposition, which for real property can run several decades. A taxpayer unable to substantiate basis on sale faces gain computed from a basis of zero, which makes this the costliest recordkeeping failure of all.

52. A — A statutory rule requires documentary evidence of amount, time, place, business purpose, and where relevant business relationship for these categories, so an unsubstantiated expense is disallowed entirely however plainly it was incurred. Reasonable estimation of a clearly incurred but imprecisely documented expense remains available only outside that statutory list. Business relationship must also be established wherever it is relevant.

53. A — A partner's share of partnership liabilities increases outside basis whoever the lender happens to be, which supports early loss deductions in a leveraged venture. An S corporation shareholder gains basis only from a direct loan, and C corporation losses trap at the entity level and never reach the shareholders at all.

54. C — Liquidating a C corporation triggers gain at both the corporate and shareholder levels, which makes a C corporation holding appreciated assets practically impossible to unwind. Moving into corporate form is generally tax free, and electing S status carries only built-in gains exposure across a five-year recognition period. Appreciated assets therefore make the structure effectively permanent.

55. B — The purchase price must be allocated across asset classes under a prescribed residual method, and both parties are required to report that allocation consistently on their returns. Buyers prefer asset purchases for the stepped-up basis, while sellers prefer entity sales producing capital gain rather than a mixture including ordinary recapture.

56. D — Recapture income is recognized in full in the year of sale even where the seller receives little or no cash that year, with only the remaining gain spread across the installment payments. A seller of heavily depreciated equipment can therefore owe substantial tax well before collecting meaningful proceeds from the buyer.

57. B — Status is determined by the preceding calendar year, averaging full-time employees together with full-time equivalents. Full-time means thirty hours weekly or one hundred thirty monthly, and equivalents are aggregate part-time hours divided by one hundred twenty. Part-time employees count toward status but are never owed coverage themselves. Part-time employees establish status but never enter the payment base.

58. D — Where the grantor retains specified powers, including a power to revoke, the trust is disregarded and its income, deductions, and credits are reported directly by the grantor. A revocable living trust is therefore a grantor trust by definition, files no separate return during the grantor's life, and becomes a separate entity at death.

59. A — Capital gains allocable to corpus are subtracted because they belong to the remainder beneficiary rather than the income beneficiary. The distribution deduction and the personal exemption are both added back, and tax-exempt income net of allocable expenses is added, producing a figure approximating the income economically available for distribution. Corpus gains belong to the remainder beneficiary instead.

60. C — First-tier distributions are amounts of income required to be distributed currently, whether or not actually paid, and they absorb distributable net income before any second-tier discretionary amount is taxed. A trustee's failure to make the required payment does not defer the beneficiary's tax on that amount. Second-tier discretionary beneficiaries share only whatever then remains.

61. A — An estate receives six hundred dollars, a simple trust required to distribute all income currently receives three hundred, and a complex trust receives one hundred. These amounts are fixed by statute rather than indexed for inflation, making them among the very few figures safely memorized regardless of the year tested.

62. D — Costs paid in connection with administering the entity that would not have been incurred if the property were not held in trust survived and remain fully deductible. Fiduciary fees, probate costs, and preparation fees for the entity's own returns all qualify, while ordinary investment advisory and custodial fees generally do not.

63. C — The operational test examines actual activities, requiring operation primarily for exempt purposes. The separate organizational test examines the governing document, which must limit purposes, avoid empowering substantial non-exempt activity, and permanently dedicate assets on dissolution. Both tests must be satisfied independently before exemption can be recognized. Neither test alone is sufficient to establish exempt status.

64. B — Private inurement is prohibited absolutely with no threshold and no substantiality test, so any part of net earnings benefiting an insider defeats exemption outright. Lobbying is permitted within limits, and unrelated business activity produces tax rather than revocation unless it becomes the organization's primary purpose over time. Primary purpose marks the point at which tax becomes revocation.

65. A — Debt-financed income is pulled into unrelated business taxable income in proportion to the outstanding acquisition indebtedness even where it would otherwise be excluded as passive. Rents attributable to personal property or measured by the tenant's profits likewise lose the exclusion, making a mortgage the decisive fact. A mortgage on investment property is therefore the decisive fact.

66. C — Three consecutive years of non-filing revokes exemption automatically by operation of law, with no notice required and effect from the third year's due date. Reinstatement requires a fresh application and fee, and the rule catches smallest organizations most often since those filing only the electronic notice often overlook it. Retroactive reinstatement requires reasonable cause and all delinquent returns.

67. B — A simplified employee pension may be established and funded as late as the extended due date of the return, which makes it the only meaningful option for a business reaching year end with nothing in place. A savings incentive match plan must generally be established by October first with no extension.

68. D — Net earnings for plan purposes equal net profit reduced by the deductible half of self-employment tax. The stated plan rate is then converted by dividing it by one plus itself, so twenty-five percent becomes twenty percent, resolving the circularity created because the contribution reduces the very base on which it is computed.

69. B — Cattle and horses held for draft, breeding, dairy, or sporting purposes require twenty-four months, while other livestock including hogs, sheep, and goats require only twelve. Poultry is excluded from the provision by statute entirely, and animals held primarily for sale remain ordinary income property regardless of period. Poultry is excluded from the provision by statute in every case.

70. A — Prepaid farm supplies are limited to fifty percent of other deductible farm expenses, with exceptions for farmers meeting a substantial-business test or where unusual circumstances caused the excess. Soil and water conservation expenditures instead face a twenty-five percent of gross farm income limit with an indefinite carryforward. A substantial-business test provides the principal available exception.

71. C — An activity where the average period of customer use is seven days or less, or thirty days or less with significant personal services, is not a rental activity at all and is tested under ordinary material participation standards. This is why a materially participating short-term lodging operator may deduct losses.

72. D — Active participation is a materially lower standard than material participation, requiring only bona fide involvement in decisions such as approving tenants and authorizing repairs, and it survives the use of a management company. The taxpayer must additionally own at least ten percent of the activity being claimed. A management company handling operations does not defeat the standard.

73. C — The ordering places interest and taxes first, operating expenses second, and depreciation last, so depreciation is always the item disallowed where rental income runs out. That sequencing favours the taxpayer, since depreciation reduces basis only to the extent actually deducted and the disallowed amount carries forward. Disallowed depreciation carries forward rather than being lost outright.

74. D — Expenses the tenant pays on the landlord's behalf are rental income, as are rents received, advance rent, lease cancellation payments, and the fair market value of property or services accepted instead of cash. A refundable deposit is not income until applied to unpaid rent or retained for damage. A refundable deposit is the notable exception to inclusion here.

75. A — Release requires disposing of the entire interest in the activity in a fully taxable transaction to an unrelated party, after which suspended losses become deductible against non-passive income. A gift, a partial disposition, or a transfer to a related party or controlled entity triggers no release whatever. Related-party and controlled-entity transfers never trigger release.

76. B — Tax-exempt income does not increase the account and its related expenses do not reduce it, though both items affect stock basis. Ordinary income, separately stated income, and recognized gains all increase it, while distributions reduce it only as far as zero and losses may drive the balance negative. Distributions reduce the account only as far as zero, never below.

77. C — A partnership subject to the centralized regime cannot amend and must file an administrative adjustment request instead, with adjustments reaching partners through statements. An S corporation, or a partnership that has validly elected out, may file an amended return with corrected statements in the ordinary way. Electing out demands both the numerical and the eligibility conditions.

78. D — The cap is the sum of business interest income, thirty percent of adjusted taxable income, and floor plan financing interest, with disallowed amounts carried forward indefinitely. A taxpayer meeting the gross receipts test that also governs accrual accounting and capitalization is exempt from the limitation altogether. Floor plan financing interest is added into the same cap.

79. A — The owner's own contribution is an adjustment to income rather than a business schedule expense, because deducting it on the business schedule would reduce net earnings again and understate self-employment tax. Contributions made on behalf of employees are properly a business expense, so one plan produces deductions in two places.

80. D — Eligibility requires fewer than twenty-five full-time equivalent employees, average annual wages below an adjusted ceiling, payment of at least half the premium cost under a qualifying arrangement, and enrolment through the small business marketplace. The credit is available for only two consecutive years and phases out as figures rise. The credit phases out as headcount or average wages climb.

81. B — The four hurdles operate in a fixed sequence and each is tested against the amount that survived the previous one rather than the original loss. Basis is tested first, then at-risk, then passive activity, then the excess business loss cap, whose disallowed remainder becomes a net operating loss carryforward. The final disallowed excess becomes a net operating loss carryforward.

82. B — Where capital is a material income-producing factor, a family member owning a genuine capital interest is recognized even if the interest was acquired by gift. The interest must be real, with the donee holding the rights of ownership rather than nominal title while the donor retains practical control. Where capital is not material, genuine services or capital are required.

83. A — A purchase between family members is treated as a gift for these rules regardless of what was actually paid, so a parent selling an interest to a child at full value remains inside the family partnership regime. Candidates commonly assume a genuine purchase breaks the analysis, and it does not.

84. C — The donor must first be allocated reasonable compensation for services rendered to the partnership, with only the remaining income divided according to capital interests. Beyond that, the donee's share attributable to capital may not be proportionately greater than the donor's share attributable to the same capital. Capital shares are then compared proportionately between the two.

85. D — Private foundations face excise taxes on net investment income, self-dealing with disqualified persons, failure to distribute a minimum amount, excess business holdings, jeopardizing investments, and taxable expenditures. Public charities face none of these, though both categories remain subject to the unrelated business income tax. Both categories nevertheless bear the unrelated business income tax.

86. C — Three elements must all be present: a trade or business, regularly carried on, and not substantially related to the exempt purpose other than through producing funds. A single annual fundraising event is not regularly carried on and escapes the tax entirely, whatever revenue that event generates. A single annual fundraising event escapes the tax on that ground.

87. A — Disqualified persons include plan fiduciaries, the employer, employee organizations, owners of half or more of the employer, and members of their families. Ordinary participants, named beneficiaries, and unrelated vendors are all excluded. The prohibition reaches sales, leasing, lending, furnishing services, and fiduciary self-dealing. Family members of those persons are likewise disqualified persons.

88. B — The entire account ceases to be an individual retirement arrangement as of the first day of the year, producing a deemed distribution of the whole balance. This is dramatically harsher than the excise tax applying to a qualified plan, and prompt correction does not cure the disqualification once it occurs.

89. D — Weather-related sales of draft, breeding, and dairy animals may be treated as involuntary conversions with a four-year replacement period, extended further by published notice where drought conditions persist regionally. Livestock held for sale rather than these purposes instead qualifies for a one-year deferral of excess proceeds. Ordinary sale livestock instead receives a one-year deferral election.

90. C — Averaging is available only to individuals, which includes partners and S corporation shareholders reporting farm income from those entities, and never to C corporations. Base year income serves only as a computational reference so those returns are unaffected, and the election may be made on an amended return. C corporations may never elect farm income averaging at all.

91. B — Both conditions must hold in the same year: more than half of all personal services performed in any trade or business must be in real property trades or businesses in which the taxpayer materially participates, together with more than seven hundred fifty hours devoted to those businesses. Licensure and ownership percentage form no part of the statutory test.

92. A — Exceeding the greater of fourteen days or ten percent of the days rented at fair value makes the property a residence, limiting deductions to rental income with no loss permitted and disallowed amounts carried forward. Use of exactly fourteen days does not exceed the threshold and leaves the property outside it.

93. B — The Service allocates using total days of use, while some court decisions have permitted allocation across all days in the year, leaving a larger share available as itemized deductions and producing a larger rental loss. Examination answers follow the Service method unless a question expressly directs otherwise. The two methods produce materially different rental loss figures.

94. C — Acquired intangibles are amortized ratably over fifteen years beginning with the month of acquisition, without regard to actual or contractual life, so a three-year covenant not to compete is still recovered over fifteen. No loss is recognized on disposing of one where others from the same acquisition are retained. The disallowed loss attaches instead to the retained intangibles' basis.

95. A — Income and deductions must be computed separately for each unrelated trade or business, so a loss from one cannot offset income from another. Losses are trapped within their own activity and carried forward against that same activity's future income, preventing profitable operations being sheltered behind unprofitable ones. Losses carry forward within their own separate activity silo.

96. D — Qualified property is measured at unadjusted basis immediately after acquisition, meaning original cost without reduction for depreciation, for property still held and within its depreciable period at year end. The limb adds twenty-five percent of wages to two and a half percent of that figure. The taxpayer claims whichever of the two limbs produces more.

97. D — Nondeductible penalties reduced book income and are never deductible for tax purposes, so they are added back. Excess tax depreciation is a deduction taken for tax but not recorded on the books and is subtracted, as are tax-exempt interest and life insurance proceeds, both being nontaxable book income. Both categories of item move in opposite directions on the schedule.

98. C — Schedule M-2 runs from the opening balance, adds book income and other increases, and subtracts distributions and other decreases to reach a closing figure that must tie to the equity section of Schedule L. For an S corporation it instead tracks the balances governing distribution taxability. An S corporation's version carries direct shareholder consequences.

99. A — Filing within twenty-seven months of the end of the month of formation produces recognition retroactive to the date of formation. A later filing produces recognition only prospectively from the application date, leaving a taxable gap covering the intervening period during which the organization operated without recognized status. The application itself remains valid; only its effective date shifts.

100. B — The limitation is the last of four hurdles, applied after basis, at-risk, and passive activity have each been tested in turn. The disallowed excess is not lost; it becomes a net operating loss carryforward to the following year, where it becomes subject to the eighty percent of taxable income limitation.