PRACTICE EXAM 13: 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 defaults to disregarded status with no classification election filed?

A. A domestic limited liability company having three members
B. A foreign entity whose members all enjoy limited liability
C. A business incorporated under a state incorporation statute
D. A domestic limited liability company having a single member

2. Which requirement applies to the responsible party on an entity's application?

A. The party must be a natural person who actually controls the entity
B. The party must own a majority of the entity's outstanding equity
C. The party must reside in the entity's state of organization
D. The party must hold a formal office such as director or officer

3. Which test does a partnership apply where no majority interest year exists?

A. The least aggregate deferral computation across candidate year ends
B. The common tax year of all of the partnership's principal partners
C. The calendar year applied as a mandatory statutory fallback rule
D. The tax year used by the partner holding the largest capital account

4. Which condition must both spouses satisfy for a qualified joint venture election?

A. Both must own equal percentage interests in the venture
B. Both must file separate returns for the taxable year involved
C. Both must materially participate in the unincorporated business
D. Both must be listed as members of a limited liability company

5. Which consequence follows a hobby determination under current law?

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

6. Which filer must submit information returns electronically?

A. Any filer submitting more than fifty returns of a single type
B. Any filer whose gross receipts exceed five million dollars
C. Any filer organized as a corporation rather than a proprietorship
D. Any filer required to submit ten or more returns in the aggregate

7. Which item is included in a partner's initial outside basis?

A. The fair market value of the partnership interest received
B. The partnership's inside basis in all of its underlying assets
C. The partner's share of partnership liabilities at contribution
D. The projected value of future distributive share allocations

8. Which contribution to a partnership produces immediate ordinary income?

A. Appreciated real property held previously for investment
B. A capital interest received in exchange for services rendered
C. Cash contributed on the formation of the partnership itself
D. Equipment subject to an assumed nonrecourse liability

9. Which liability allocation applies to a nonrecourse partnership liability?

A. Allocation according to the partners' shares of partnership profits
B. Allocation to the partner bearing the economic risk of loss
C. Allocation equally among all general and limited partners
D. Allocation in proportion to each partner's capital account

10. Which item reduces a partner's outside basis without being a loss?

A. An allocation of tax-exempt interest income for the year
B. A decrease in the partner's share of partnership liabilities
C. A capital contribution made during the taxable year
D. An increase in the partner's share of partnership liabilities

11. Which distribution triggers gain to a partner?

A. A distribution of appreciated land exceeding outside basis
B. A distribution of inventory exceeding the partner's basis
C. Money distributed in excess of the partner's outside basis
D. A distribution of equipment carrying depreciation recapture

12. Which item is included in the amount realized on a partnership interest sale?

A. The seller's capital account balance at the start of the year

B. The partnership's inside basis in its underlying business assets
C. The buyer's projected share of future partnership profits
D. The seller's share of partnership liabilities assumed by the buyer

13. Which condition terminates a partnership under current law?

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

14. Which authority does a partnership representative hold?

A. Exclusive authority to bind the partnership and all of its partners
B. Authority shared with partners holding a majority interest
C. Authority limited to receiving notices for the partnership
D. Authority to settle only where every affected partner consents

15. Which requirement must be met for a partnership to elect out of the centralized regime?

A. The partnership must have fifty or fewer partners in total
B. The partnership must obtain advance consent from the Service
C. Every partner must be an eligible type of person for that year
D. The partnership must have existed for at least three years

16. Which requirement defines control for Section 351 purposes?

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

17. Which item constitutes boot in a Section 351 exchange?

A. A corporate debt security issued to the transferring shareholder
B. Voting common stock of the transferee corporation received
C. Nonvoting common stock carrying identical economic rights
D. Additional shares received later through a stock split

18. Which liability is excluded from the excess-over-basis computation?

A. A mortgage incurred to acquire the transferred real property
B. A liability assumed by the shareholder rather than the corporation
C. A liability whose payment would itself give rise to a deduction
D. A liability arising after the transfer has been completed

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

A. Federal income taxes actually paid during the taxable year
B. Life insurance proceeds received on a key employee policy
C. Nondeductible fines assessed by a regulatory authority
D. Premiums where the corporation is the policy beneficiary

20. Which rule applies where current earnings are positive but accumulated earnings show a deficit?

A. The deficit is netted first, so no dividend arises at all
B. The distribution is a tax-free return of capital in every case
C. The distribution produces capital gain from a deemed stock sale
D. The distribution is a dividend to the extent of current earnings and profits

21. Which redemption test is measured at the corporate level?

A. The partial liquidation test requiring a genuine business contraction
B. The substantially disproportionate redemption test
C. The complete termination of shareholder interest test
D. The not essentially equivalent to a dividend test

22. Which corporation faces the accumulated earnings tax?

A. One meeting both the ownership and passive income tests
B. One with more than half its receipts derived from services
C. One retaining any earnings at the close of the taxable year
D. One accumulating earnings beyond reasonable needs to avoid shareholder tax

23. Which shareholder disqualifies a corporation from S status?

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

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

A. A personal guarantee of corporate borrowing from a bank
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 security for a corporate loan

25. Which restoration ordering applies where both bases were reduced by losses?

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

26. 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

27. Which condition must exist for the passive investment income termination?

A. Accumulated earnings and profits carried over from C corporation years
B. Passive income exceeding half of the corporation's gross receipts
C. At least five shareholders holding a majority of the stock
D. An S election made within the preceding three taxable years

28. Which method must a taxpayer use where gross receipts exceed the threshold?

A. The cash method with inventories treated as materials
B. A hybrid method combining cash and accrual elements
C. The completed contract method for all long-term work
D. The accrual method of accounting for the business activity

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

A. Freight charges incurred in acquiring the merchandise sold
B. Merchandise the owner withdrew from inventory for personal use
C. Trade discounts allowed by suppliers on their invoices
D. Storage costs for goods awaiting sale to future customers

30. Which requirement accompanies a last-in, first-out inventory election?

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 applies only to goods acquired after the election
D. The method must also be used in reports to creditors and owners

31. Which amount is excluded from a taxpayer's at-risk figure?

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

32. Which discharge produces no cancellation of indebtedness income?

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

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

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

34. Which risk attends compensation 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 currently deducted

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

A. A child aged sixteen employed by a parent's sole proprietorship
B. A spouse employed by the other spouse'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

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

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

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

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

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

A. Permitting employees to retain any unspent travel advances

B. Reimbursing employees more than once each calendar month
C. Requiring receipts for expenditures below a stated amount
D. Reimbursing meals at the fifty percent deductible rate

39. 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

40. 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

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

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

42. Which item is excluded from qualified business income?

A. Ordinary income from a domestic manufacturing partnership
B. Rental income from a domestic trade or business activity
C. Section 179 expense allocated on the owner's Schedule K-1
D. Guaranteed payments received by a partner for services rendered

43. Which business retains the deduction at any income level?

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

44. Which figure caps a post-2017 net operating loss deduction?

A. Fifty percent of adjusted gross income for the carryover year
B. Eighty percent of taxable income computed before the loss deduction
C. One hundred percent of taxable income without any limitation
D. The amount of business income reported for that same year

45. Which item is a permanent book-tax difference?

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

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

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

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

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

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

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

49. Which record must be kept until the disposition year's limitations period expires?

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

50. Which entity form permits entity 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 bears personal liability

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

A. Capital gain attributable to the appreciated land component

B. Depreciation recapture income arising on the property sold
C. Interest income accruing on the deferred payment balance
D. Gain deferred and reported as payments are actually collected

52. Which figure determines applicable large employer status?

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

53. Which trust files no separate return during the grantor's lifetime?

A. A complex trust accumulating income at trustee discretion
B. A simple trust distributing all of its income currently
C. A revocable living trust, being a grantor trust by definition
D. An electing small business trust holding operating shares

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

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

55. 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
C. The beneficiary who received a distribution earliest in the year
D. The beneficiary entitled to income required to be distributed currently

56. 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

57. 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 commensurate test applied to program expenditure levels
D. The operational test requiring operation primarily for exempt purposes

58. Which conduct defeats charitable exemption absolutely?

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

59. 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

60. Which plan must generally be established by the first of October?

A. A simplified employee pension funded by the extended due date
B. A savings incentive match plan for employees of a small firm
C. A profit sharing plan adopted before the plan year closes
D. A defined benefit plan certified by an enrolled actuary

61. Which livestock requires twenty-four months of holding for Section 1231 treatment?

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

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

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

63. Which activity falls outside the per se passive rental classification?

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

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

A. Active participation together with at least ten percent ownership

B. Material participation exceeding five hundred hours annually
C. Qualification as a real estate professional for that same year
D. Ownership of the property for more than twenty-four months

65. Which expense is disallowed first where the vacation home limitation applies?

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

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

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

67. Which disposition releases suspended passive losses in full?

A. A gift of the whole interest to an adult child of the owner
B. A fully taxable disposition of the entire interest to an unrelated party
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

68. 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. A partnership furnishing more than one hundred Schedules K-1
D. An S corporation correcting an error on a previously filed return

69. Which figure caps the business interest deduction 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

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

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

71. 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. Enrolment through the small business health options marketplace
D. Availability across an unlimited number of consecutive years

72. Which statement about the four loss limitation hurdles is correct?

A. Each is tested against the amount surviving the previous hurdle
B. Each is tested independently against the original allocated loss
C. The passive activity rules are applied before the basis test
D. The excess business loss cap is applied before the at-risk test

73. Which condition recognizes a family member as a partner where capital is material?

A. Contribution of services of substantial value to the business
B. Acquisition of the interest by purchase for full consideration
C. Genuine ownership of a capital interest, however it was acquired
D. Attainment of the age of majority under applicable state law

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

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

75. Which excise tax reaches private foundations but not 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 substantial donor
D. A tax on failure to distribute a minimum amount annually

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

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

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

A. Any participant holding an account balance within the plan

B. An owner of fifty percent or more of the sponsoring employer
C. Any beneficiary designated to receive benefits upon death
D. Any vendor supplying goods to the employer's own business

78. 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 applies to condemned business real property
D. Four years, extendable where drought persists across a region

79. Which taxpayer may elect farm income averaging?

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

80. Which condition must a real estate professional satisfy besides the hours test?

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

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

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

82. 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

83. 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 recovered only upon disposition of the entire business
D. It is amortized over fifteen years regardless of its actual life

84. 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 one aggregate computation
C. Only the most profitable activity need be reported at all
D. Losses may offset the organization's exempt function income

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

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

86. 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

87. Which item is a first-tier distribution from a trust?

A. A discretionary distribution of corpus to a remainder beneficiary
B. A distribution made within sixty-five days of the year's close
C. Income required to be distributed currently under the instrument
D. Any distribution actually paid out during the taxable year

88. Which condition triggers a trust's obligation to file an income tax return?

A. Distribution of any amount to a beneficiary during the year
B. Any taxable income for the year, whatever the gross amount
C. Ownership of assets exceeding six hundred dollars in value
D. Existence of more than one beneficiary under the instrument

89. Which cost survived the suspension of miscellaneous itemized deductions for a trust?

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

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

A. The disallowed excess is permanently lost to the taxpayer

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

91. 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

92. Which consequence follows a prohibited transaction in an individual retirement arrangement?

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

93. Which vesting schedule may apply to employer contributions in a qualified plan?

A. Five-year cliff vesting or ten-year graded vesting
B. Three-year cliff vesting or six-year graded vesting
C. Immediate full vesting in every circumstance without exception
D. Vesting only upon attaining normal retirement age under the plan

94. Which period governs retroactive recognition of an organization's exemption?

A. Twelve months from the close of the organization's first year
B. Thirty-six months from the date operations first commenced
C. Twenty-seven months from the end of the month of formation
D. Six months from the date the governing document was adopted

95. Which farm expenditure requires consistency with an approved conservation plan?

A. Fertilizer applied to growing crops during the season
B. Soil and water conservation expenditures made on farmland
C. Prepaid feed acquired before the consumption season
D. Repairs to machinery used in ordinary field operations

96. Which condition must a savings incentive match plan employer satisfy?

A. It must have fewer than twenty-five full-time equivalent employees
B. It must maintain at least one other qualified retirement plan
C. It must contribute a discretionary amount determined annually
D. It must have one hundred or fewer employees and no other qualified plan

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

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

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 G, identifying substantial stock ownership interests
D. Schedule M-2, which must agree with the balance sheet equity

99. Which item is excluded in computing an individual's net operating loss?

A. Ordinary business losses from an active trade or business
B. Depreciation claimed on property used in the business
C. Capital losses in excess of capital gains for the taxable year
D. Wages paid to employees during the loss year in question

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

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

Practice Exam 13: Answer Key and Explanations

1. D — A domestic eligible entity with one member is disregarded by default, so its activity flows onto the member's own return exactly as a sole proprietorship would. Two or more domestic members produce partnership classification instead, a foreign entity with universal limited liability defaults to corporate treatment, and a state-law corporation has no election available.

2. A — The responsible party must be a natural person actually controlling or directing the entity and its assets, rather than another entity or a nominee, and must supply a personal taxpayer identification number. Applications are limited to one per responsible party each day, and a change must be reported within sixty days.

3. B — The hierarchy runs majority interest year first, then the common year of all principal partners owning five percent or more, and only then the least aggregate deferral computation. Each step is reached solely where the preceding one produces no answer, so the arithmetic comes last rather than first. The arithmetic therefore comes last rather than first in the analysis.

4. C — The election requires an unincorporated business jointly owned and operated by a married couple who both materially participate and file a joint return. It is generally unavailable where the business is a state-law entity, though separate guidance permits disregarded treatment for a spousal company in a community property state. A community property state offers the one narrow alternative route.

5. A — 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 activity's gross receipts. The suspension of those deductions has been made permanent.

6. D — The threshold is ten or more information returns counted in aggregate across all form types rather than per form, so a payer filing six of one form and five of another crosses the line even though neither category alone would. Form W-9 is used separately to collect payee identification numbers.

7. C — Initial outside basis equals money contributed, plus the adjusted basis of any property contributed, plus the partner's share of partnership liabilities, less any liabilities of the partner assumed by the partnership. Fair market value of the interest plays no part, and a purchased interest instead takes a cost basis. A purchased interest instead takes a straightforward cost basis.

8. B — Services are not property, so the nonrecognition provision does not shelter them. A capital interest received for services is compensation, taxable at the fair market value of the interest received, which then becomes the partner's basis. A profits interest is generally not taxable on receipt under published guidance. A profits interest is treated far more favourably on receipt.

9. A — A nonrecourse liability, for which no partner bears the economic risk of loss, is generally allocated according to profit shares, while a recourse liability goes to whoever actually bears that risk. This distinction explains why a limited partner's basis is typically supported by nonrecourse rather than recourse debt. Limited partners therefore rely on nonrecourse debt for basis.

10. B — A decrease in liability share is treated as a distribution of money, reducing basis and producing gain where it exceeds basis. It belongs in the distribution step of the ordering rather than the loss step, a placement that changes the answer in any year where the partner's basis runs out.

11. C — Gain arises only where money distributed exceeds outside basis, since property other than money simply absorbs basis rather than requiring it. Marketable securities are generally treated as money for this rule, so distributing publicly traded stock can produce gain where distributing land or equipment cannot. Marketable securities are generally treated as money for this purpose.

12. D — Relief from the seller's share of liabilities is included in the amount realized, so gain can arise on a sale producing modest cash and, in a heavily leveraged partnership, on one producing none at all. Section 751 then separates the ordinary hot-asset component from the residual capital gain. Leverage can therefore produce gain on a cashless sale entirely.

13. B — 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 alone no longer close the year or restart depreciation. Technical termination on a fifty percent transfer no longer exists.

14. A — The representative holds exclusive authority to act in any proceeding and binds the partnership and every partner. The representative need not be a partner but must have a substantial presence in the

United States, and individual partners have no independent right to notice, participation, or contest under the regime. This is a sharp departure from the regime it replaced.

15. C — 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. A single ineligible partner defeats it however small the firm.

16. D — 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 value.

17. A — Corporate securities such as long-term debt instruments are boot rather than stock, as is nonqualified preferred stock carrying debt-like features. Only genuine stock qualifies for nonrecognition, and boot triggers gain equal to the lesser of realized gain or boot received, while loss is never recognized regardless. Only genuine stock in the transferee escapes boot treatment.

18. C — Liabilities whose payment would generate a deduction, most commonly a cash-basis taxpayer's accounts payable, are excluded from the excess computation. Without this rule a cash-basis proprietor incorporating a going concern would recognize gain merely for transferring routine trade payables along with the business itself. The liability still reduces stock basis when it is assumed.

19. B — Death benefits received on a key employee policy, net of cash surrender value, increase earnings and profits despite being excluded from taxable income, as do tax-exempt interest and the dividends received deduction. Federal income taxes, fines, and life insurance premiums are all outlays reducing capacity to distribute. The measure gauges economic capacity rather than taxable income.

20. D — Under the nimble dividend rule the two pools are tested separately, so positive current earnings and profits support dividend treatment even where accumulated earnings show a deficit, and that deficit does not offset the current amount. Netting them produces the wrong answer, which always appears among the options. That netting error is always among the options offered.

21. A — The partial liquidation test is measured at the corporate level and generally requires a genuine contraction of the business. The other three routes to exchange treatment examine the shareholder's proportionate interest before and after, and all four apply only after constructive ownership rules attribute shares held by relatives. Attribution rules apply before every one of the four tests.

22. D — The tax reaches a corporation permitting earnings to accumulate beyond the reasonable needs of the business for the purpose of avoiding tax at the shareholder level. It is asserted by the Service on examination rather than self-reported, and it cannot apply in a year the corporation is a personal holding company.

23. B — Nonresident aliens are ineligible shareholders, as are partnerships, corporations, and most trusts. Estates, resident aliens, and qualifying trusts are all permitted holders. Eligibility is continuous rather than tested once, so a shareholder later becoming a nonresident alien terminates the election on the day the status changes. Eligibility is continuous rather than tested once at election.

24. C — Debt basis arises only from a direct loan creating genuine indebtedness running from the corporation to that shareholder, requiring an actual economic outlay. A guarantee, a pledge of personal collateral, and corporate third-party borrowing all produce nothing until the shareholder actually pays and becomes a creditor. Only an actual economic outlay by the shareholder will suffice.

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

26. 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 the balance, while distributions reduce it only as far as zero and losses may drive it negative. Distributions reduce it only as far as zero, never below.

27. A — Both conditions are required: passive investment income exceeding twenty-five percent of gross receipts for three consecutive years, and accumulated earnings and profits carried over from C corporation years. A corporation that has always been an S corporation may hold entirely passive investments without any exposure. Three consecutive years above the threshold are also required.

28. D — The accrual method is required where average annual gross receipts exceed the applicable threshold, and that same test governs exemption from the uniform capitalization rules and from inventory accounting. A taxpayer crossing the threshold generally becomes subject to all three regimes at once rather than only one. Crossing the threshold engages all three regimes together.

29. B — Merchandise removed for personal use must be subtracted from purchases, since treating it as a business expense or ignoring it entirely overstates cost of goods sold and understates gross profit by that amount. Freight is added into inventoriable cost, and trade discounts reduce the invoice price directly. Freight is instead added into the inventoriable cost of goods.

30. D — 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 lenders. The election applies until the Service consents to a change of method. Lower of cost or market may not be combined with it.

31. C — Nonrecourse financing carries no personal liability and is excluded from amounts at risk, though it does increase basis under the liability sharing rules. Qualified nonrecourse financing secured by real property is the narrow exception, available only to real property activities rather than to equipment ventures. The activity's own assets pledged as security add no exposure.

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

33. D — 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. The reduction equals the amount excluded rather than forgiven.

34. 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 falls on precisely the disallowed portion.

35. A — 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 these exemptions.

36. B — 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. Business expenses at the destination survive in either case.

37. D — 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 qualifies only where separately stated on the invoice. Club dues and recreational outings fall under the same bar.

38. A — 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.

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

40. 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 above straight line. Under current recovery methods that usually amounts to nothing.

41. A — 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 repealed law.

42. D — Guaranteed payments are excluded on the same reasoning that excludes S corporation reasonable compensation, both being payments for services rather than a share of business profits. Capital gains, dividends, investment interest, foreign income, and employee service income are all likewise outside the definition entirely. Ordinary domestic business income remains inside the definition.

43. C — 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, while consulting, accounting, and brokerage all appear and lose it. The wage and property limitations nevertheless continue to apply.

44. B — The deduction is capped at eighty percent of taxable income computed without the net operating loss deduction itself and without the qualified business income deduction. Computing eighty percent of income already reduced by the loss produces a circular and wrong answer offered as a standard distractor. Pre-2018 losses are used first and carry no percentage limit.

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

46. D — 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. Voluntary correction also brings audit protection for earlier years.

47. A — 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 apply.

48. B — The penalty reaches any responsible person, meaning anyone with the authority and duty to direct payment, which may include officers, bookkeepers, and occasionally outside advisors. Wilfulness requires only knowledge that taxes were unpaid plus a decision to pay other creditors instead of the Service. The liability survives dissolution and is not discharged in bankruptcy.

49. C — 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 entirely. Basis of zero is presumed where records cannot be produced.

50. A — A partner's share of partnership liabilities increases outside basis whoever the lender happens to be, supporting early loss deductions in a leveraged venture. An S corporation shareholder gains basis only from a direct loan, and C corporation losses trap at entity level and never reach shareholders. A guarantee alone produces no basis until it is actually paid.

51. B — 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 owe substantial tax before collecting meaningful proceeds. Only the remaining gain spreads across the installment payments.

52. D — 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 establish status but are owed no coverage. Equivalents are part-time hours divided by one hundred twenty.

53. C — A retained power to revoke is itself a triggering power, so a revocable living trust is a grantor trust by definition. Its income, deductions, and credits are reported directly by the grantor and it is disregarded as a separate taxpayer, becoming a separate entity only upon the grantor's death. It becomes a separate taxable entity upon the grantor's death.

54. B — 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 distributable income. Corpus gains belong to the remainder beneficiary instead.

55. D — 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 it. Second-tier beneficiaries share only whatever then remains.

56. 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 safely memorized regardless of the year being tested. These figures are fixed by statute and never indexed.

57. D — The operational test examines actual activities, requiring operation primarily for exempt purposes, while the separate organizational test examines the governing document, which must limit purposes, avoid empowering substantial non-exempt activity, and dedicate assets on dissolution. Both must be satisfied for exemption. Neither test alone suffices to establish exempt status. This distinction is tested regularly on the examination.

58. C — 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 primary purpose. Primary purpose marks where tax becomes outright revocation.

59. 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 tenant profits likewise lose the exclusion under separate provisions. A mortgage on investment property is the decisive fact here.

60. B — The savings incentive match plan must generally be established by October first for the year it is to be effective, a deadline carrying no extension whatever. A simplified employee pension may instead be established and funded as late as the extended return due date, making it the post-year-end option. No extension of that October deadline is available at all.

61. D — 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 months. Poultry is excluded from the provision by statute entirely, and animals held primarily for sale remain ordinary income property. Poultry is excluded from the provision by statute entirely.

62. C — 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. A substantial-business test provides the principal exception.

63. A — 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 material participation standards. A materially participating short-term lodging operator may therefore deduct losses. Long-term rentals remain passive however much effort is spent.

64. A — 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. A management company handling operations does not defeat it.

65. B — 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 it is actually deducted. Disallowed depreciation carries forward rather than being lost.

66. C — 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 or retained for damage. A refundable deposit is the notable exception to inclusion.

67. B — 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 related-party transfer triggers no release whatever of the trapped losses. Related-party and controlled-entity transfers never trigger release.

68. D — 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 validly electing out, may file an amended return with corrected statements in the ordinary way. Electing out demands both numerical and eligibility conditions.

69. 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 governing accrual accounting and capitalization is exempt from the limitation entirely. Floor plan financing interest is added into the same cap.

70. B — The owner's own contribution is an adjustment to income rather than a business schedule expense, because deducting it there would reduce net earnings again and understate self-employment tax. Contributions made on behalf of employees are properly a business expense of the enterprise itself. Contributions made for employees are properly a business expense.

71. C — 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 runs for only two consecutive years. The credit phases out as headcount or average wages climb.

72. A — The hurdles operate in a fixed sequence and each is tested against the amount that survived the previous one, never against the original loss. Basis comes first, then at-risk, then passive activity, then the excess business loss cap producing a net operating loss carryforward. The final disallowed excess becomes a loss carryforward instead.

73. C — Where capital is a material income-producing factor, a family member owning a genuine capital interest is recognized even if 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 are required.

74. B — 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 market value remains inside the family partnership regime. A genuine purchase does not break the analysis at all. Candidates commonly assume a purchase breaks the analysis.

75. 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 bear the unrelated business income tax. Public charities face none of these additional foundation taxes.

76. A — 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 it generates. Producing funds alone never establishes substantial relation.

77. B — Disqualified persons include plan fiduciaries, the employer, employee organizations, owners of half or more of the employer, and members of their families. Ordinary participants, beneficiaries, and unrelated vendors are excluded. The prohibition reaches sales, leasing, lending, furnishing services, and fiduciary self-dealing. Family members of those persons are likewise disqualified. This distinction is tested regularly on the examination.

78. 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 persists regionally. Livestock held for sale instead qualifies for a one-year deferral of the excess proceeds. Ordinary sale livestock receives a one-year deferral instead.

79. C — Averaging is available only to individuals, including 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 earlier returns are unaffected by making the election. C corporations may never elect farm income averaging at all.

80. A — 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 in those businesses. Licensure and ownership percentage form no part of the test.

81. C — Exceeding the greater of fourteen days or ten percent of days rented at fair value makes the property a residence, limiting deductions to rental income with no loss permitted. Use of exactly fourteen days does not exceed the threshold and leaves the property outside the limitation. Below the threshold a rental loss may still be claimed.

82. 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 directed otherwise. The two methods produce materially different loss figures.

83. D — 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 years rather than three under the governing provision. No loss arises on disposing of one while others are retained.

84. 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 in later years. Profitable operations cannot be sheltered behind unprofitable ones.

85. A — 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 a percentage of that figure. The taxpayer claims whichever of the two limbs produces more.

86. D — Nondeductible penalties reduced book income and are never deductible for tax, 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 received. Both categories move in opposite directions on the schedule.

87. C — First-tier distributions are amounts of income the instrument requires to be distributed currently, whether or not actually paid, and they absorb distributable net income before any second-tier discretionary amount is taxed at all in the hands of its recipient. A trustee's failure to pay does not defer the beneficiary's tax.

88. B — The trust thresholds are disjunctive, so a return is required where the trust has any taxable income at all, or gross income of six hundred dollars or more, or any beneficiary who is a nonresident alien. Meeting a single condition triggers the obligation entirely. Estates by contrast apply only the gross income threshold.

89. A — Costs paid in connection with administering the entity that would not have been incurred if the property were not held in trust survived the suspension and remain fully deductible. Fiduciary fees, probate costs, and return preparation fees for the entity all qualify under this carve-out. Ordinary investment advisory fees generally fall outside it.

90. D — The limitation is the last of four hurdles, applied after basis, at-risk, and passive activity have each been tested. The disallowed excess is not lost; it becomes a net operating loss carryforward subject to the eighty percent limitation in the following year. Basis, at-risk, passive, then the aggregate business loss cap.

91. 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 the smallest organizations most frequently of all. Retroactive reinstatement demands reasonable cause and all returns.

92. A — 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 it. Prompt correction does not cure the disqualification once it occurs.

93. B — Employer contributions must vest under a three-year cliff or a six-year graded schedule. Employee elective deferrals vest immediately in every plan, as do all contributions to simplified employee pensions and savings incentive match plans, while top-heavy plans require accelerated vesting. Employee elective deferrals always vest immediately in every plan. This distinction is tested regularly on the examination.

94. C — 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 operating period entirely. The application itself remains valid; only its date shifts.

95. B — Soil and water conservation expenditures are deductible currently rather than capitalized, but only for land used in farming, only where consistent with an approved conservation plan, and only up to twenty-five percent of gross farm income with indefinite carryforward of any excess. The plan must be approved before the deduction is claimed.

96. D — The plan is available to employers with no more than one hundred employees who maintain no other qualified plan. The employer must either match dollar for dollar up to three percent of compensation or contribute two percent nonelectively for every eligible employee, and contributions vest immediately. Both formulas are mandatory rather than discretionary annually.

97. B — 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 whatever. Bonus depreciation can instead generate a net operating loss. This distinction is tested regularly on the examination.

98. D — 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 the balance sheet presented on Schedule L. A mismatch signals an equity entry that bypassed the schedule. This distinction is tested regularly on the examination.

99. C — Capital losses exceeding capital gains are excluded because they follow their own carryover regime. The computation also excludes the net operating loss deduction itself and the qualified business income deduction, and allows nonbusiness deductions only to the extent of nonbusiness income. Personal deductions cannot therefore generate a business carryover. This distinction is tested regularly on the examination.

100. A — 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 producing a carryforward. A loss stopped at any hurdle never reaches the next one.