PRACTICE EXAM 14: 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 where no election has been filed?

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

2. Which period governs how far forward a classification election may be made effective?

A. Thirty days after the date the election form is filed
B. Seventy-five days after the date the form is actually filed
C. Twelve months after the date the election form is filed
D. The first day of the year following the filing of the form

3. Which event obliges a business to obtain a new employer identification number?

A. A sole proprietor taking on a partner and operating jointly
B. A corporation electing to be taxed under Subchapter S
C. A partnership admitting several additional partners
D. A business changing its trade name and relocating premises

4. Which deferral does a Section 444 election permit an entity to adopt?

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

5. Which activity uses the relaxed two-of-seven-years profit presumption?

A. Breeding, training, showing, or racing of horses by the taxpayer
B. Commercial farming producing row crops for sale at market
C. Charter fishing operated from a vessel the taxpayer owns
D. Antique dealing conducted from a permanent retail location

6. Which item constitutes business income even though no cash was received?

A. Capital contributed to the business by its owner in the year
B. Loan proceeds deposited into the business operating account
C. A transfer of funds from the owner's personal savings account
D. Goods or services accepted in a barter exchange arrangement

7. Which basis does a partnership take in property a partner contributes?

A. The fair market value of the property on the contribution date
B. The average of adjusted basis and fair market value at contribution
C. The contributing partner's adjusted basis, carried over unchanged
D. Zero until the property is placed in service by the partnership

8. Which item increases a partner's outside basis despite never being taxed?

A. A cash distribution received during the taxable year in question
B. The partner's distributive share of tax-exempt income for the year
C. A decrease in the partner's share of partnership liabilities
D. The partner's share of nondeductible, noncapital expenses

9. Which loss limitation is tested first for a partner claiming a Schedule K-1 loss?

A. The at-risk limitation excluding most nonrecourse financing
B. The passive activity limitation for nonparticipating partners
C. The excess business loss limitation applying in the aggregate
D. The basis limitation measured by the partner's outside basis

10. Which item is a hot asset when a partner sells a partnership interest?

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

11. 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

12. Where are the cancellation of debt exclusions applied for a partnership?

A. At the partner level, against each partner's own circumstances

B. At the partnership level before any allocation to the partners
C. At whichever level produces the smaller taxable amount overall
D. At the partnership level for bankruptcy and partner level for insolvency

13. Which requirement must a partnership meet to elect out of the centralized audit 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

14. Which requirement defines control for Section 351 purposes?

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

15. Which item received in a Section 351 exchange constitutes boot?

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

16. Which liability treatment applies where a shareholder borrows against property days before transferring it?

A. Only the excess of liabilities over property basis produces gain
B. The liability reduces stock basis with no gain arising at all
C. The transaction fails Section 351 entirely and is fully taxable

D. The entire liability assumed is treated as boot received

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

A. Federal income taxes actually paid during the taxable year
B. Tax-exempt interest received on municipal bond holdings
C. Nondeductible fines assessed by a regulatory authority
D. Life insurance premiums where the corporation is beneficiary

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

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

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

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

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

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

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

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

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

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

23. 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. Gain recognized on distributing appreciated corporate property
D. Tax-exempt interest earned on municipal obligations held

24. Which condition must exist for the built-in gains tax to reach a disposition?

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

25. Which taxpayer may never use the cash method of accounting?

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

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

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

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

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

28. 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. Warehousing of finished goods still awaiting sale to customers
D. Research and experimental costs for developing new products

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

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

30. Which discharge of indebtedness produces no income to the debtor?

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

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

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

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

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

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

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

34. Which travel expense remains 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

35. 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. Entertainment such as tickets purchased for a business client
D. Meals treated as compensation and included in employee wages

36. 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 any unspent travel advances

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

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

38. 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. None, because equipment produces Section 1231 gain entirely
D. All depreciation previously allowed or allowable on that asset

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

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

40. Which item is excluded from the definition of 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

41. 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 own clients

42. 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. Indefinite carryforward with no carryback except for farming losses

D. Twenty-year carryforward expiring where not fully absorbed

43. 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. Warranty reserves accrued for financial reporting purposes
D. Federal income tax expense recorded on the corporate books

44. 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 useful life of the affected property
D. Recognition only when the related property is finally disposed of

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

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

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

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

47. Which record must be retained 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

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

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

49. 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

50. 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

51. 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

52. 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

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

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

54. Which exemption amount applies to a complex trust?

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

55. 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

56. Which conduct defeats charitable exemption absolutely with no threshold?

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

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

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

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

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

59. 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

60. Which farm deduction is limited to fifty percent of other deductible 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

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

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

62. Which requirement accompanies the special rental real estate loss allowance?

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

63. Which expense is disallowed first 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

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

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

65. Which disposition releases suspended passive losses in full?

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

66. 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. Gain recognized on distributing appreciated corporate property
D. Tax-exempt interest earned on municipal obligations held

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

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

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

A. Business interest income plus thirty percent of adjusted taxable income
B. Fifty percent of the taxpayer's gross receipts for the year
C. Twenty percent of the taxpayer's qualified business income

D. The amount of interest actually paid rather than merely accrued

69. 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

70. 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

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

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

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

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

73. 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

74. 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 failure to distribute a minimum amount annually
D. A tax on contributions received from a single substantial donor

75. 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

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

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

77. 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. Four years, extendable where drought persists across a region
C. One year, matching the ordinary deferral election period
D. Three years, as applies to condemned business real property

78. 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

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

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

80. 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

81. 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 by the relative fair rental value of each period
C. Allocation using the total days the property was actually used

D. Allocation entirely to the rental use of the dwelling itself

82. 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

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

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

84. 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

85. 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

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

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

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

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

88. Which cost 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. Fiduciary fees that would not have arisen but for the trust
D. Management fees on rental property held purely for investment

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

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

90. 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. Automatic revocation of exemption by operation of law
C. Conversion of the organization to private foundation status
D. A requirement to obtain a fresh determination letter only

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

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

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

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

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

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

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

A. Soil and water conservation expenditures made on farmland
B. Fertilizer applied to growing crops during the season
C. Prepaid feed acquired before the consumption season

D. Repairs to machinery used in ordinary field operations

95. 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

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

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

97. 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

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

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

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

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

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

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

Practice Exam 14: Answer Key and Explanations

1. B — A domestic eligible entity with two or more members defaults to partnership classification whenever no election has been filed. Disregarded treatment reaches only single-member domestic entities, and a state-law corporation is a per se corporation with no classification election available to it at all. A foreign entity with universal limited liability defaults to corporate treatment instead.

2. C — The effective date may be set as late as twelve months after the filing date, or as early as seventy-five days before it. Absent a specified date the election takes effect on the day it is filed with the Service. All members must generally consent to the election being made.

3. A — A new number is required only where a genuinely new entity comes into existence, and a sole proprietor taking on a partner creates a partnership, which is a different taxpayer entirely. An S election changes only how an existing corporation is taxed and creates nothing new. Changes in partnership membership leave the same entity in place.

4. D — The 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 but nothing earlier. Partnerships and S corporations making the election must compute a required payment functioning as a deposit. Personal service corporations instead face a minimum distribution requirement.

5. A — Activities consisting primarily of breeding, training, showing, or racing horses use the relaxed two-of-seven test rather than the ordinary standard. All other activities use three profitable years out of five consecutive years ending with the year in question. A form may be filed to postpone the determination until the presumption period has fully run.

6. D — Bartered goods and services are included at the fair market value of whatever was received, so a contractor accepting accounting services in exchange for renovation work has income equal to the value of those services. Capital contributions increase the bank balance without producing income. Loan proceeds are borrowings rather than receipts.

7. C — The partnership takes a carryover basis equal to the contributor's adjusted basis immediately before the contribution. The partner separately takes a substituted basis in the partnership interest received, computed on the same figure. Fair market value plays no role whatever in either computation. Any appreciation is preserved rather than recognized on the transfer itself.

8. B — Tax-exempt income increases outside basis even though it is never taxed, which preserves the exemption when the partnership interest is eventually disposed of. Nondeductible noncapital expenses form the exact mirror image, reducing basis despite producing no deduction at all. Distributions and decreases in liability share both reduce basis as well.

9. D — The four hurdles operate in a fixed sequence and basis is always tested first. Only the amount surviving that limitation is then measured against amounts genuinely at risk, then against passive income from other sources, and finally against the aggregate excess business loss cap. A loss stopped at any hurdle never reaches the next one.

10. C — The definition of unrealized receivables reaches well beyond conventional receivables to capture depreciation recapture potential embedded in depreciable property. A partnership holding heavily depreciated equipment therefore carries hot assets even where it has no receivables at all. The portion of gain attributable to those assets becomes ordinary income. Only the residual balance receives ordinary capital gain treatment on sale.

11. 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 of interests has been repealed entirely. Ownership changes therefore no longer close the tax year or restart depreciation schedules.

12. A — Cancellation income flows through as a separately stated item, and the bankruptcy, insolvency, and other exclusions are all tested against each partner's own position. An insolvent partnership therefore provides no relief whatever to a solvent partner. A solvent partnership may allocate excludable income to an insolvent partner who excludes it entirely.

13. C — Electing out requires both that the partnership furnish one hundred or fewer Schedules K-1 and that every single partner be an eligible type of person. Trusts, partnerships, disregarded entities, and nominees are all ineligible partners. A single ineligible partner therefore defeats the election however small the partnership happens to be.

14. A — Control requires at least eighty percent of the total combined voting power of all classes entitled to vote, and at least eighty percent of the total number of shares of each other class. Both prongs must hold at the same moment. The second prong is measured by share count within each class rather than by aggregate value.

15. B — 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 in the transferee corporation qualifies for full nonrecognition. Receiving boot triggers gain equal to the lesser of realized gain or the boot received. Loss is never recognized under the provision regardless of the boot involved.

16. D — Where the principal purpose of the assumption is avoidance of federal income tax, or there is no bona fide business purpose for it, the entire liability becomes boot rather than merely the excess over basis. Borrowing against unencumbered property shortly before transfer and retaining the proceeds is the classic targeted pattern. The economics resemble simply receiving cash.

17. B — Tax-exempt interest is cash genuinely received and increases earnings and profits despite never entering taxable income at all. Life insurance proceeds and the dividends received deduction operate the same way and are likewise added back. Federal income taxes, nondeductible fines, and life insurance premiums are all real economic outlays. Each such outlay reduces the corporation's genuine capacity to distribute.

18. C — Only the second tier, the tax-free return of capital, reduces stock basis. The dividend tier does not touch basis at all, however large the distribution happens to be. The third tier arises only once basis has already been driven to zero by the second. The third tier arises only once basis has already reached zero.

19. D — 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 in an S corporation. A single ineligible shareholder terminates the election on the very day the disqualifying transfer occurs rather than at year end.

20. A — The one class of stock requirement looks solely to identical rights in distribution and liquidation proceeds. Differences in voting rights are expressly permitted by statute, making voting and nonvoting common the standard succession planning structure. Preferred stock carrying a priority dividend creates a second class and defeats the election immediately on issue.

21. A — 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 personal guarantee produces nothing at all until the guarantee is called and the shareholder actually pays. Pledging personal collateral is likewise insufficient by itself. Corporate third-party borrowing never creates shareholder basis at all.

22. C — Losses reduce stock basis first and debt basis second, while restoration in a later profitable year runs in precisely the opposite direction. A net increase rebuilds debt basis up to the amount by which it was previously reduced before any stock basis is restored. This ordering protects the shareholder's loan ahead of the equity investment.

23. D — Tax-exempt income does not increase the account and its related expenses do not reduce it, though both items nevertheless affect stock basis. The account tracks income already taxed once to the shareholders. Ordinary income, separately stated income, and recognized gains all increase the balance. Distributions reduce the balance only as far as zero and never below.

24. B — The tax reaches only appreciation economically present at the date of conversion from C to S status. It applies where that appreciation is 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 its assets have appreciated.

25. A — Tax shelters may never use the cash method whatever their size or receipts. Personal service corporations, farming corporations meeting the applicable conditions, and service businesses without inventories may all use it. The gross receipts test otherwise governs whether the accrual method becomes mandatory. That same threshold determines exemption from inventory accounting and from the uniform capitalization rules alike.

26. D — Merchandise removed for personal use must be subtracted from purchases rather than deducted as a business expense. Treating it as an expense or ignoring it entirely overstates cost of goods sold and understates gross profit by exactly that amount. Freight is instead added into the inventoriable cost of the goods acquired.

27. B — The conformity requirement obliges a taxpayer electing the method for tax purposes to use it in reports to shareholders, partners, and creditors. A taxpayer cannot claim the tax benefit of lower reported income while showing higher earnings to a lender. The election is made on a prescribed form and applies until the Service consents to a change.

28. C — Storage and warehousing of goods before sale is an indirect cost requiring capitalization into inventory. Purchasing, handling, quality control, production depreciation, and allocable overhead are all capitalized on the same footing. Selling, advertising, distribution to customers, and research and experimentation remain currently deductible period costs. The dividing line is whether goods await a buyer or move toward one.

29. A — Nonrecourse financing carries no personal liability and is therefore excluded from amounts at risk, though it does increase basis under the liability sharing rules. This gap between basis and at-risk amount explains most cases where a taxpayer with apparently adequate basis still cannot deduct a loss. Qualified nonrecourse financing secured by real property is the narrow exception.

30. D — 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 produces no income either. A shareholder-creditor contributing debt to capital likewise creates none. Only genuinely gratuitous discharge reaches the statutory exclusions.

31. B — The prescribed order begins with net operating losses, then 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 actually excluded rather than the amount forgiven. A taxpayer may elect to reduce depreciable property basis first instead.

32. A — In a C corporation the danger runs toward compensation that is too high rather than too low. Excessive amounts paid to a shareholder-employee are recharacterized as dividends, which are not deductible by the corporation while remaining fully taxable to the recipient. Double taxation therefore falls on precisely the disallowed portion.

33. C — 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. That child remains exempt from federal unemployment tax until reaching age twenty-one. Spouses and parents employed in the business stay subject to Social Security while escaping unemployment tax.

34. B — Where a domestic trip is primarily personal, transportation to and from the destination is entirely nondeductible. Expenses incurred at the destination that are directly attributable to business nevertheless remain deductible. Where the trip is primarily for business instead, transportation becomes fully deductible even though some personal time is taken. Foreign travel follows separate allocation rules subject to several defined exceptions.

35. C — Entertainment produces no deduction at all regardless of business purpose, which captures tickets, club dues, sporting events, and recreational outings alike. Business meals remain fifty percent deductible where the taxpayer or an employee is present and the meal is not lavish. Meals at company-wide recreational events and meals included in wages remain fully deductible.

36. 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 of those conditions entirely. Failure of any single condition converts the whole arrangement for every participant rather than only the offending payment. Employee business deductions are suspended, so no offset survives.

37. C — Residential rental property carries a twenty-seven and a half year recovery period, while nonresidential real property runs thirty-nine years. Both are recovered straight line under the mid-month convention regardless of when in the month they are placed in service. Land improvements such as fencing and drainage tile run fifteen years.

38. D — Section 1245 recaptures all depreciation allowed or allowable as ordinary income before any Section 1231 treatment becomes available. The ordinary component therefore equals the lesser of total depreciation claimed or total gain realized. Only the residual balance receives Section 1231 netting treatment. Only the residual balance then receives Section 1231 netting treatment.

39. B — Section 1031 now applies exclusively to real property held for productive use in a trade or business or for investment. Real property is broadly like kind to other real property, so improved may be exchanged for unimproved and urban for rural. Equipment, vehicles, livestock, and partnership interests are excluded in every circumstance.

40. A — Reasonable compensation paid to a shareholder-employee is wages rather than qualified business income and is therefore excluded. Guaranteed payments to partners are excluded on exactly the same reasoning, both being payments for services. Capital gains, dividends, investment interest, and foreign income are also outside the definition. Guaranteed payments to partners are excluded on identical reasoning.

41. B — Engineering and architecture are conspicuously absent from the statutory list of specified service trades or businesses, despite appearing in comparable provisions elsewhere in the Code. Both therefore retain the deduction at any income level. They remain subject only to the wage and property limitations that apply to every non-service business.

42. C — Losses arising after 2017 carry forward indefinitely with no carryback at all, except two years for qualifying farming losses. The deduction in any carryforward 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 and carry no percentage limitation.

43. D — Federal income tax reduces book income and is never deductible for tax purposes, so the difference is permanent and never reverses in a later period. Permanent differences change the effective rate of tax the corporation ultimately bears. Bad debt allowances, accelerated depreciation, and warranty reserves all reverse over time. Temporary differences affect only timing rather than total tax borne.

44. A — A positive adjustment increasing income spreads ratably over four years beginning with the year of change. A negative adjustment decreasing income is instead taken entirely in that single year. Candidates frequently apply the four-year spread symmetrically, which is wrong in both directions. The asymmetry encourages voluntary rather than forced correction.

45. D — Relief requires reasonable basis, substantive consistency, and reporting consistency, and all three must hold simultaneously. Failure to file the required 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. The reporting condition is what defeats most claims in actual practice.

46. A — The penalty reaches any responsible person, meaning anyone with the authority and duty to direct payment of the withheld amounts. It can reach officers, bookkeepers, and occasionally outside advisors. Wilfulness requires only knowledge that the taxes were unpaid plus a decision to pay other creditors instead. No intent to defraud is required, and the liability survives dissolution and bankruptcy alike.

47. C — Basis records must survive as long as the asset does, and then through the limitations period for the year of disposition. For real property that can mean several decades of retention. A taxpayer unable to substantiate basis on sale faces gain computed from a basis of zero. A basis of zero is presumed where records cannot be produced.

48. B — 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, since a guarantee produces nothing until actually paid. C corporation losses trap at the entity level and never reach shareholders.

49. B — Recapture income is recognized in full in the year of sale even where the seller receives little or no cash in that year. Only the gain remaining after recapture is spread across the installment payments as they are received. A seller of heavily depreciated equipment can therefore owe substantial tax before collecting meaningful proceeds.

50. D — Status is determined by reference to the preceding calendar year, averaging full-time employees together with full-time equivalents. Full-time means thirty hours weekly or one hundred thirty hours monthly. Equivalents are computed by aggregating part-time hours for a month and dividing by one hundred twenty. Part-time employees count toward establishing status but are never owed coverage and never trigger a payment.

51. 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 the trust is disregarded as a separate taxpayer. It becomes a separate taxable entity only upon the grantor's death.

52. 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 to taxable income. Tax-exempt income net of allocable expenses is then added, producing a figure approximating the income economically available for current distribution.

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

54. B — The exemption is one hundred dollars for a complex trust, three hundred for a simple trust required to distribute all income currently, and six hundred for an estate. These amounts are fixed by statute rather than indexed for inflation. That makes them among the very few figures in fiduciary taxation safely memorized regardless of year.

55. C — The operational test examines actual activities, requiring the organization to be operated 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.

56. D — Private inurement is prohibited absolutely, with no threshold and no substantiality test applied. Any part of net earnings benefiting an insider defeats exemption outright. Lobbying is permitted within limits, and an expenditure election may measure substantiality objectively. Unrelated business activity produces tax rather than revocation unless it becomes the organization's primary purpose.

57. B — 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. A mortgage on investment property is therefore the decisive fact in these questions.

58. A — The savings incentive match plan must generally be established by October first for the year it is to be effective, and that deadline carries no extension whatever. A simplified employee pension may instead be established and funded as late as the extended return due date. That makes the pension the only option available after year end.

59. D — Cattle and horses held for draft, breeding, dairy, or sporting purposes require twenty-four months of holding. Other livestock including hogs, sheep, and goats require only twelve months to qualify. Poultry is excluded from the provision by statute entirely, whatever the purpose of holding. Animals held primarily for sale remain ordinary income property regardless of period.

60. C — Prepaid farm supplies are limited to fifty percent of other deductible farm expenses for the year. Exceptions apply 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. That separate limit carries an indefinite carryforward of the excess.

61. D — An activity where the average period of customer use is seven days or less is not a rental activity at all. The same applies where use averages thirty days or less with significant personal services provided. Such activities are tested under ordinary material participation standards instead. This is why a materially participating short-term lodging operator may deduct losses.

62. B — Active participation is a materially lower standard than material participation. It requires only bona fide involvement in management decisions such as approving tenants, setting terms, and authorizing repairs. It survives the use of a management company handling day-to-day operations. The taxpayer must additionally own at least ten percent of the activity being claimed.

63. C — The ordering places interest and taxes first, operating expenses second, and depreciation last of all. Depreciation is therefore always the item disallowed where rental income runs out before the expenses do. That sequencing favours the taxpayer, since depreciation reduces basis only to the extent actually deducted. The disallowed amount carries forward to later years.

64. A — Expenses the tenant pays on the landlord's behalf are rental income when received. So are rents, 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 caused by the tenant.

65. C — Release requires disposing of the entire interest in the activity in a fully taxable transaction to an unrelated party. The suspended losses then become deductible against non-passive income as well as passive. A gift, a partial disposition, or a transfer to a related party or controlled entity triggers no release whatever of the trapped losses.

66. D — 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. Distributions reduce it only as far as zero and never below. Losses, by contrast, may drive the balance negative in a poor year.

67. B — A partnership subject to the centralized regime cannot amend at all and must file an administrative adjustment request instead. Adjustments then reach partners through statements rather than corrected Schedules K-1. An S corporation, or a partnership that has validly elected out of the regime, may file an amended return with corrected statements in the ordinary way.

68. A — The cap is the sum of business interest income, thirty percent of adjusted taxable income, and floor plan financing interest. Disallowed amounts carry forward indefinitely to later years. A taxpayer meeting the gross receipts test that also governs accrual accounting and capitalization is exempt from the limitation altogether, which removes it from most small business returns.

69. B — The owner's own contribution is an adjustment to income rather than a business schedule expense. Deducting it on the business schedule would reduce net earnings a second time and understate self-employment tax. Contributions made on behalf of employees are properly a business expense. One plan therefore produces deductions in two entirely different places on the return.

70. D — Eligibility requires fewer than twenty-five full-time equivalent employees and average annual wages below an adjusted ceiling. The employer must pay at least half the premium cost under a qualifying arrangement. Enrolment must be through the small business marketplace established for that purpose. The credit runs for only two consecutive years and phases out as headcount or wages rise.

71. C — The hurdles operate in a fixed sequence, and each is tested against the amount that survived the previous one rather than the original loss. Basis comes first, then at-risk, then passive activity, then the excess business loss cap. A loss stopped at any hurdle never reaches the next. The final disallowed excess becomes a net operating loss carryforward.

72. A — Where capital is a material income-producing factor, a family member owning a genuine capital interest is recognized even if that interest was acquired by gift. The interest must be real, with the donee holding the actual rights of ownership. Nominal title while the donor retains practical control does not suffice. Where capital is not material, genuine services are required instead.

73. B — A purchase between family members is treated as a gift for these rules regardless of what was actually paid. A parent selling an interest to a child at full market value therefore remains inside the family partnership regime. Candidates commonly assume a genuine purchase breaks the analysis. It does not, and questions are built on that assumption.

74. C — 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 additional taxes. Both categories nevertheless remain subject to the unrelated business income tax on qualifying activities they conduct.

75. 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. Producing funds alone never establishes substantial relation, however worthy the ultimate use of the money.

76. D — 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 from the definition. The prohibition reaches sales, leasing, lending, furnishing goods or services, and any self-dealing by a plan fiduciary.

77. B — Weather-related sales of draft, breeding, and dairy animals may be treated as involuntary conversions with a four-year replacement period. That period is extended further by published notice where drought conditions persist across a region. Livestock held for sale rather than these purposes instead qualifies for a one-year deferral of the excess proceeds received.

78. C — Averaging is available only to individuals, which includes partners and S corporation shareholders reporting farm income from those entities. C corporations may never elect it whatever their farming activity. Base year income serves only as a computational reference, so those earlier returns are unaffected. The election may be made or changed on an amended return.

79. D — Both conditions must hold in the same taxable 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. More than seven hundred fifty hours must be devoted to those businesses. Licensure and ownership percentage form no part of the test.

80. A — Exceeding the greater of fourteen days or ten percent of the days rented at fair value makes the property a residence. Deductions are then limited to rental income with no loss permitted, and disallowed amounts carry forward. Use of exactly fourteen days does not exceed the threshold. Below it, a rental loss may still be claimed subject to passive limits.

81. C — The Service allocates using total days of use during the year. Some court decisions have instead permitted allocation across all days in the year, which leaves a larger share available as itemized deductions and produces a larger rental loss. The two methods produce materially different figures. Examination answers follow the Service method unless a question expressly directs otherwise.

82. D — Acquired intangibles are amortized ratably over fifteen years beginning with the month of acquisition, without regard to actual or contractual life. A three-year covenant not to compete is therefore still recovered over fifteen years. No loss is recognized on disposing of a single such intangible where others from the same acquisition are retained by the taxpayer.

83. B — Income and deductions must be computed separately for each unrelated trade or business conducted. A loss from one activity therefore cannot offset income from another. Losses are trapped within their own activity and carried forward against that same activity's future income. This prevents profitable operations being sheltered behind consistently unprofitable ones.

84. A — Qualified property is measured at unadjusted basis immediately after acquisition, meaning original cost without any reduction for depreciation. It counts only where the property is 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 limb produces more.

85. 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 therefore subtracted. Tax-exempt interest and life insurance proceeds are both nontaxable book income and are subtracted as well.

86. B — First-tier distributions are amounts of income the instrument requires to be distributed currently, whether or not actually paid. They absorb distributable net income before any second-tier discretionary amount is taxed. A beneficiary entitled to mandatory income is therefore taxed even where the trustee failed to make the payment during the year.

87. A — The trust filing thresholds are disjunctive rather than cumulative. 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. Estates by contrast apply only the gross income threshold.

88. C — 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. Fiduciary fees, probate costs, and preparation fees for the entity's own returns all qualify. Ordinary investment advisory and custodial fees of a kind individuals commonly incur generally fall outside the carve-out.

89. A — 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 to the taxpayer at all. It becomes a net operating loss carryforward to the following year, where it becomes subject to the eighty percent of taxable income limitation instead.

90. B — 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. Retroactive reinstatement demands reasonable cause and all delinquent returns. The rule catches the smallest organizations most often of all.

91. C — The entire account ceases to be an individual retirement arrangement as of the first day of the year. That produces a deemed distribution of the whole balance rather than merely the amount involved. This is dramatically harsher than the excise tax applying to a qualified plan. Prompt correction does not cure the disqualification once it has occurred.

92. D — Employer contributions must vest under a three-year cliff schedule or a six-year graded schedule. Employee elective deferrals vest immediately in every plan without exception. All contributions to simplified employee pensions and savings incentive match plans likewise vest immediately. A top-heavy plan requires accelerated vesting beyond these ordinary statutory baselines. Employer contributions are the only ones following a schedule.

93. B — 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. That leaves a taxable gap covering the intervening period of operation. The application itself remains valid; only its effective date shifts forward.

94. A — Soil and water conservation expenditures are deductible currently rather than capitalized, but only for land used in farming. The expenditure must be consistent with an approved conservation plan before any deduction is allowed. The deduction is capped at twenty-five percent of gross farm income. Any excess is carried forward indefinitely to later taxable years.

95. 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 deferrals dollar for dollar up to three percent of compensation or contribute two percent nonelectively for every eligible employee. Both formulas are mandatory rather than discretionary, and all contributions vest immediately.

96. C — The deduction cannot exceed aggregate taxable income from the active conduct of any trade or business. It can therefore never create or increase a loss for the taxpayer. Disallowed amounts carry forward indefinitely to later years. Bonus depreciation carries no comparable income limitation and can instead generate a net operating loss usable elsewhere.

97. D — Schedule M-2 runs from the opening balance, adds net income per books and other increases, and subtracts distributions and other decreases. The closing figure must agree with the equity section of Schedule L. A mismatch signals an equity entry that bypassed the schedule. For an S corporation it instead tracks balances governing distribution taxability.

98. A — Capital losses exceeding capital gains are excluded because they follow their own separate carryover regime. The computation also excludes the net operating loss deduction itself and the qualified business income deduction. Nonbusiness deductions are allowed only to the extent of nonbusiness income. Personal deductions therefore cannot generate a business loss carryover.

99. B — Both conditions must be present: 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 indefinitely. It faces no exposure whatever on this particular ground.

100. C — 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. The disallowed remainder at the final stage becomes a net operating loss carryforward.