PRACTICE EXAM 15: 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 where no classification election is filed?

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

2. Which requirement applies to the responsible party named 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 reach only after the majority interest year fails?

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

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 materially participate in the unincorporated business
C. Both must file separate returns for the taxable year involved
D. Both must be listed as members of a limited liability company

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

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

6. Which filer must submit information returns electronically?

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

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 projected value of future distributive share allocations
D. The partner's share of partnership liabilities at the contribution date

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

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

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

A. Allocation to the partner bearing the economic risk of loss
B. Allocation according to the partners' shares of partnership profits
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. A decrease in the partner's share of partnership liabilities
B. An allocation of tax-exempt interest income for the year
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. Money distributed in excess of the partner's outside basis
C. A distribution of inventory exceeding the partner's 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 seller's share of partnership liabilities assumed by the buyer
D. The buyer's projected share of future partnership profits

13. Which condition terminates a partnership under current law?

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

14. Which authority does a partnership representative hold?

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

15. Which requirement must a partnership meet to elect out of the centralized regime?

A. Every partner must be an eligible type of person for that year
B. The partnership must have fifty or fewer partners in total
C. The partnership must obtain advance consent from the Service
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 issued
B. Fifty-one percent of the total combined voting power alone
C. Eighty percent of voting power and of each nonvoting class of shares
D. One hundred percent ownership by the transferring group

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

A. Voting common stock of the transferee corporation received
B. Nonvoting common stock carrying identical economic rights
C. A corporate debt security issued to the transferring shareholder
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 whose payment would itself give rise to a deduction
C. A liability assumed by the shareholder rather than the corporation
D. A liability arising after the transfer has been completed

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

A. Life insurance proceeds received on a key employee policy
B. Federal income taxes actually paid during the taxable year
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 accumulating earnings beyond reasonable needs to avoid shareholder tax
C. One with more than half its receipts derived from services
D. One retaining any earnings at the close of the taxable year

23. Which shareholder disqualifies a corporation from S status?

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

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. Debt basis is restored first, up to the amount previously reduced

B. Stock basis is restored first because equity ranks ahead of debt
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. Passive income exceeding half of the corporation's gross receipts
B. At least five shareholders holding a majority of the stock
C. An S election made within the preceding three taxable years
D. Accumulated earnings and profits carried over from C corporation years

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

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

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

A. Freight charges incurred in acquiring the merchandise sold
B. Trade discounts allowed by suppliers on their invoices
C. Merchandise the owner withdrew from inventory for personal use
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. Nonrecourse financing obtained for an equipment leasing activity
C. The adjusted basis of property contributed to the 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. Net operating loss carryovers available to the taxpayer
D. Foreign tax credit carryovers accumulated to that date

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. Compensation being capitalized rather than currently deducted
D. Excessive amounts being recharacterized as nondeductible dividends

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. Entertainment such as tickets purchased for a business client
C. Meals provided at a company-wide recreational gathering
D. Meals treated as compensation and included in employee wages

38. 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

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

A. Residential rental property acquired for letting to tenants
B. Nonresidential real property used in a trade or business
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 that asset
D. None, because equipment produces Section 1231 gain entirely

41. 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

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. Guaranteed payments received by a partner for services rendered
D. Section 179 expense allocated on the owner's Schedule K-1

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

A. An engineering firm providing structural design services
B. A consulting practice advising corporate management clients
C. An accounting firm preparing tax and audit engagements
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. One hundred percent of taxable income without any limitation
C. The amount of business income reported for that same year
D. Eighty percent of taxable income computed before the loss deduction

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

46. 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 property
D. Recognition only when the related property is disposed of

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

A. Reliance on long-standing practice in a significant industry segment
B. Failure to file the required information returns for those workers
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. Only an officer owning a majority of the outstanding stock
C. Any responsible person who wilfully failed to remit the withheld taxes
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. Copies of information returns furnished to contractors
D. Records establishing the basis of business property held

50. Which entity form permits entity debt to support an owner's loss deduction?

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

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

A. Depreciation recapture income arising on the property sold

B. Capital gain attributable to the appreciated land component
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. Full-time employees plus full-time equivalents in the preceding year
C. Total employees appearing on the payroll at any point in the year
D. Full-time employees averaged across the current calendar year

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

A. A complex trust accumulating income at trustee discretion
B. A revocable living trust, being a grantor trust by definition
C. A simple trust distributing all of its income currently
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. Tax-exempt income net of its allocable expenses incurred
C. The distribution deduction claimed for amounts paid out
D. Capital gains allocable to corpus for the taxable year

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

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

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. Accumulating income rather than granting it out currently
D. Any part of net earnings benefiting a private insider

59. 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

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 profit sharing plan adopted before the plan year closes
C. A savings incentive match plan for employees of a small firm
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. Cattle and horses held for breeding or dairy purposes
D. Poultry raised for eventual sale to processing operations

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

A. Soil and water conservation expenditures made on farmland
B. Prepaid feed, seed, and fertilizer acquired ahead of the season
C. Veterinary services provided to productive breeding stock
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. Material participation exceeding five hundred hours annually

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

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

A. Depreciation allocable to the rental use of the property
B. Mortgage interest allocable to the rental use portion
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. The landlord's own outlay on maintaining the rented property
D. Expenses the tenant pays on the landlord's own behalf

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 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

68. 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

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. Genuine ownership of a capital interest, however it was acquired
C. Acquisition of the interest by purchase for full consideration
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 treated as a gift for family partnership purposes
B. It is respected as an arm's length sale in every circumstance
C. It terminates the partnership for federal income tax purposes
D. It requires the partnership to obtain a new identification number

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

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

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

77. 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. An owner of fifty percent or more of the sponsoring employer
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 individual partner reporting farm income on a Schedule K-1
C. An exempt organization running an agricultural research station
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 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

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 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

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. 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

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. Nondeductible penalties recorded as expense on the books
D. Excess of tax depreciation over the book depreciation figure

87. 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

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

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

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

93. 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

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

A. Twenty-seven months from the end of the month of formation
B. Twelve months from the close of the organization's first year
C. Thirty-six months from the date operations first commenced
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. Prepaid feed acquired before the consumption season
C. Soil and water conservation expenditures made on farmland
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 have one hundred or fewer employees and no other qualified plan
C. It must maintain at least one other qualified retirement plan
D. It must contribute a discretionary amount determined annually

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. 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

98. Which schedule analyses unappropriated retained earnings?

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

99. 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

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. The excess business loss cap is applied before the basis test
D. Each hurdle is tested against the amount surviving the previous one

Practice Exam 15: Answer Key and Explanations

1. C — A domestic eligible entity with one member is disregarded by default, so its activity flows directly onto the member's own return 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 at all.

2. A — The responsible party must be a natural person who actually controls or directs the entity and its assets, rather than another entity or a nominee. That person must supply a personal taxpayer identification number. Applications are limited to one per responsible party each day. A change in that person must be reported within sixty days on the prescribed form.

3. D — 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. The arithmetic therefore comes last rather than first. Ties at the final step permit the partnership to choose.

4. B — The election requires an unincorporated business jointly owned and operated by a married couple who both materially participate and file a joint return. It avoids partnership return preparation and lets each spouse build an independent self-employment earnings record. It is generally unavailable where the business is a state-law entity such as a limited liability company.

5. C — Hobby expenses produce no deduction whatever under current law. The former 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 and no carryforward. There is no reduction against the gross receipts of the activity either.

6. A — The threshold is ten or more information returns counted in aggregate across all form types rather than per form. A payer filing six of one form and five of another therefore crosses the line even though neither category alone would. Form W-9 is used separately to collect payee identification numbers. Backup withholding applies where a correct number is not furnished.

7. D — Initial outside basis equals money contributed, plus the adjusted basis of any property contributed, plus the partner's share of partnership liabilities. Liabilities of the partner assumed by the partnership are subtracted from that total. Fair market value of the interest plays no part whatever. A purchased interest instead takes a straightforward cost basis.

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

9. B — A nonrecourse liability, for which no partner bears the economic risk of loss, is generally allocated according to profit shares. A recourse liability goes instead to whoever actually bears that risk, ordinarily the general partners. This distinction explains why a limited partner's basis is typically supported by nonrecourse rather than recourse debt in a leveraged venture.

10. A — A decrease in liability share is treated as a distribution of money to that partner. It reduces basis and produces gain where the deemed distribution exceeds basis. It belongs in the distribution step of the ordering rather than the loss step. That placement changes the answer in any year where the partner's basis runs out.

11. B — Gain arises only where money distributed exceeds outside basis. Property other than money simply absorbs basis rather than requiring it, so no gain results however appreciated the property. Marketable securities are generally treated as money for this rule. Distributing publicly traded stock can therefore produce gain where distributing land or equipment cannot.

12. C — Relief from the seller's share of liabilities is included in the amount realized on the sale. Gain can therefore 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 the seller reports.

13. D — 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. Ownership changes therefore no longer close the tax year or restart depreciation schedules. A two-partner buyout is the common terminating pattern.

14. B — The representative holds exclusive authority to act in any proceeding and binds the partnership together with every one of its partners. The representative need not be a partner but must have a substantial presence in the United States. Individual partners have no independent right to notice, participation, or contest. This is a sharp departure from the regime it replaced.

15. A — 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 partners. A single ineligible partner defeats the election however small the partnership. The partnership must also notify each partner within thirty days.

16. C — Control requires at least eighty percent of the total combined voting power of all classes entitled to vote. It also requires eighty percent of the total number of shares of each other class. Both prongs must hold at the same moment, and the second is measured by share count rather than value. Failing either prong defeats the exchange for everyone.

17. C — Corporate securities such as long-term debt instruments are boot rather than stock. Nonqualified preferred stock carrying debt-like features is treated the same way despite its label. Only genuine stock in the transferee corporation qualifies for full nonrecognition. Boot triggers gain equal to the lesser of realized gain or boot received, while loss is never recognized.

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

19. A — Death benefits received on a key employee policy, net of cash surrender value, increase earnings and profits despite being excluded from taxable income. Tax-exempt interest and the dividends received deduction operate the same way. Federal income taxes, fines, and life insurance premiums are all genuine outlays. Each reduces the corporation's real capacity to distribute.

20. D — Under the nimble dividend rule the two pools are tested entirely separately. Positive current earnings and profits therefore support dividend treatment even where accumulated earnings show a deficit. That deficit does not offset the current amount at all. Netting them produces the wrong answer, which always appears 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 the redemption. All four apply only after constructive ownership rules attribute shares held by relatives and certain entities.

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

23. D — Nonresident aliens are ineligible shareholders, as are partnerships, corporations, and most trusts. Estates, resident aliens, and qualifying trusts are all permitted holders of S corporation stock.

Eligibility is continuous rather than tested once at election. A shareholder who later becomes a nonresident alien therefore terminates the election on the day that status changes.

24. C — Debt basis arises only from a direct loan creating genuine indebtedness running from the corporation to that shareholder. An actual economic outlay is required before any basis exists. A guarantee produces nothing at all until it is called and the shareholder actually pays. Pledging personal collateral and corporate third-party borrowing are likewise insufficient.

25. A — 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. This protects the shareholder's loan ahead of the equity investment. 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 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 it only as far as zero, while losses may drive it negative.

27. D — Both conditions are required for termination on this ground. Passive investment income must exceed twenty-five percent of gross receipts for three consecutive years, and accumulated earnings and profits must be carried over from C corporation years. A corporation that has always been an S corporation may hold entirely passive investments indefinitely without any exposure whatever.

28. B — The accrual method is required where average annual gross receipts exceed the applicable threshold. That same test governs exemption from the uniform capitalization rules and from inventory accounting. A taxpayer crossing the threshold therefore generally becomes subject to all three regimes at once. Tax shelters may never use the cash method whatever their receipts.

29. C — 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 that amount. Freight is instead added into inventoriable cost. Trade discounts reduce the invoice price directly rather than appearing separately.

30. D — The conformity requirement obliges a taxpayer electing the method for tax purposes to use it in reports to shareholders, partners, and creditors. The tax benefit of lower reported income cannot be claimed while higher earnings are shown to a lender. The election applies until the Service consents to a change.

31. B — Nonrecourse financing carries no personal liability and is excluded from amounts at risk, though it does increase basis under the liability rules. This gap explains most cases where a taxpayer with apparently adequate basis cannot deduct a loss. Qualified nonrecourse financing secured by real property is the narrow exception. It reaches real property activities only.

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 income. Debt cancelled as a gift produces no income either. A shareholder-creditor contributing debt to capital creates none. Forgiveness of an amount deductible if paid produces nothing, since inclusion and deduction would offset.

33. C — 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 excluded rather than the amount forgiven. A taxpayer may elect to reduce depreciable property basis first instead.

34. D — 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 the corporation cannot deduct while the recipient remains fully taxable. Double taxation therefore falls on precisely the disallowed portion. The S corporation risk reverses entirely toward understated wages.

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. The child stays exempt from unemployment tax until reaching twenty-one. Spouses and parents remain subject to Social Security while escaping unemployment tax. Incorporating destroys every one of these exemptions.

36. 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 personal time is taken. Foreign travel follows separate allocation rules.

37. B — Entertainment produces no deduction at all regardless of business purpose, which captures tickets, club dues, 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 events and meals included in wages remain fully deductible. Bundled invoices defeat the food deduction entirely.

38. D — An accountable plan requires a business connection, substantiation within a reasonable period, and return of any excess advance. Allowing employees to keep unspent advances defeats the third condition 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.

39. A — 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 placement date within the month. Land improvements run fifteen years. Qualified improvement property also runs fifteen years and is additionally eligible for Section 179 expensing.

40. C — 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. Real property follows the gentler Section 1250 rule, which under current methods usually recaptures nothing.

41. 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. Equipment, vehicles, livestock, and partnership interests are excluded in every circumstance. Material describing equipment trade-ins reflects law repealed years ago.

42. C — Guaranteed payments are excluded on the same reasoning that excludes S corporation reasonable compensation. Both are payments for services rather than a share of business profits. Capital gains, dividends, investment interest, foreign income, and employee service income are likewise outside the definition. Ordinary income from a domestic trade or business remains firmly inside it.

43. A — Engineering and architecture are conspicuously absent from the statutory list of specified service trades or businesses. Both therefore retain the deduction at any income level, subject only to the wage and property limitations. Consulting, accounting, and brokerage all appear on the list. Each loses the deduction entirely once income exceeds the upper threshold.

44. D — 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. That wrong figure appears as a standard distractor. Pre-2018 losses are used first and carry no limitation.

45. D — Federal income tax reduces book income and is never deductible for tax, so the difference is permanent and never reverses. Permanent differences change the effective rate of tax the corporation ultimately bears. Bad debt allowances, accelerated depreciation, and warranty reserves all reverse in later periods. Those temporary differences affect only when tax is paid.

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

47. B — Relief requires reasonable basis, substantive consistency, and reporting consistency, all holding 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 defeats most claims in practice.

48. C — 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 taxes were unpaid plus a decision to pay other creditors. The liability survives dissolution and is not discharged in bankruptcy.

49. D — 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. General records run three years and employment tax records four.

50. C — A partner's share of partnership liabilities increases outside basis whoever the lender happens to be. That 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 paid. C corporation losses trap at entity level and never reach the shareholders at all.

51. A — Recapture income is recognized in full in the year of sale even where the seller receives little or no cash. Only the gain remaining after recapture is spread across the installment payments as they arrive. A seller of heavily depreciated equipment can owe substantial tax before collecting meaningful proceeds. That timing mismatch is a recurring planning trap.

52. B — 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 aggregate part-time hours divided by one hundred twenty for each month. Part-time employees establish status but are never owed coverage themselves.

53. B — 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. The trust is disregarded as a separate taxpayer entirely. It becomes a separate taxable entity only upon the grantor's death.

54. D — 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. The result approximates income economically available for current distribution.

55. C — 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. 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.

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. That makes them among the very few figures in fiduciary taxation safely memorized regardless of the year tested.

57. A — The operational test examines actual activities, requiring operation primarily for exempt purposes. The separate organizational test examines the governing document, which must limit purposes and permanently dedicate assets on dissolution. The document must also avoid expressly empowering substantial non-exempt activities. Both tests must be satisfied independently before exemption can be recognized.

58. D — Private inurement is prohibited absolutely, with no threshold and no substantiality test applied to it. Any part of net earnings benefiting an insider defeats exemption outright. Lobbying is permitted provided it is not a substantial part of activities. Unrelated business activity produces tax rather than revocation unless it becomes the primary purpose.

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

60. C — The savings incentive match plan must generally be established by October first for the year it is to be effective. 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 has passed.

61. C — 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.

62. B — 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 face a separate twenty-five percent of gross farm income limit. That limit carries an indefinite carryforward of the excess.

63. A — 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. Such activities are tested under ordinary material participation standards instead. A materially participating short-term lodging operator may therefore deduct losses.

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

65. A — 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. That sequencing favours the taxpayer, since depreciation reduces basis only to the extent actually deducted. The disallowed amount carries forward to later years rather than being lost.

66. D — Expenses the tenant pays on the landlord's behalf are rental income when received. So are rents, advance rent, lease cancellation payments, and the 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.

67. 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. A gift, a partial disposition, or a transfer to a related party triggers no release. A transfer to a controlled entity is likewise insufficient.

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

69. D — 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 taxable years. A taxpayer meeting the gross receipts test governing accrual accounting and capitalization is exempt entirely. That removes the limitation from most small business returns.

70. 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 different places.

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

72. A — The hurdles operate in a fixed sequence, and each is tested against the amount that survived the previous one. 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.

73. B — 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 actual rights of ownership. Nominal title while the donor retains practical control does not suffice. Where capital is not material, genuine services are required.

74. A — 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 exploit that assumption.

75. 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. The list of foundation-only taxes is long and heavily tested.

76. D — 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. Producing funds alone never establishes substantial relation however worthy the ultimate use.

77. C — 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 excluded. The prohibition reaches sales, leasing, lending, and furnishing goods or services. Self-dealing by a fiduciary is separately prohibited outright.

78. D — 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 persists regionally. Livestock held for sale rather than these purposes instead qualifies for a one-year deferral. Purpose of holding therefore determines which relief applies.

79. B — Averaging is available only to individuals, including 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 earlier returns are unaffected. The election may be made or changed on an amended return.

80. A — 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 forms no part of the statutory test.

81. 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.

82. 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. That approach leaves a larger share available as itemized deductions and produces a larger rental loss. Examination answers follow the Service method unless a question expressly directs otherwise.

83. D — Acquired intangibles are amortized ratably over fifteen years beginning with the month of acquisition. Actual or contractual life is disregarded entirely, so a three-year covenant not to compete is still recovered over fifteen. No loss is recognized on disposing of a single such intangible where others from the same acquisition are retained by the taxpayer.

84. B — Income and deductions must be computed separately for each unrelated trade or business. 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.

85. A — Qualified property is measured at unadjusted basis immediately after acquisition, meaning original cost without 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 a percentage of that figure. The taxpayer claims whichever limb produces more.

86. C — 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. Tax-exempt interest and life insurance proceeds are both nontaxable book income. Both categories move in opposite directions on the schedule.

87. 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 at all. A beneficiary entitled to mandatory income is therefore taxed even where the trustee failed to make the payment during the year.

88. D — 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 nonresident alien beneficiary. 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. Fiduciary fees, probate costs, and return preparation fees for the entity all qualify. Ordinary investment advisory and custodial fees generally fall outside the carve-out and remain suspended.

90. B — 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. There it becomes subject to the eighty percent of taxable income limitation instead.

91. C — Three consecutive years of non-filing revokes exemption automatically by operation of law. No notice is required, and revocation takes effect from the third year's due date. Reinstatement requires a fresh application and fee. Retroactive reinstatement additionally demands reasonable cause and the filing of all delinquent returns. The rule catches the smallest organizations most often of all.

92. D — 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 only 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 occurs.

93. 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 baselines. Employer contributions are the only ones following any schedule.

94. A — Filing within twenty-seven months of the end of the month of formation produces recognition retroactive to the date of formation. A later filing produces recognition only prospectively from the application date. That leaves a taxable gap covering the intervening period of operation. The application itself remains valid; only its effective date shifts forward.

95. C — 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 years.

96. B — 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. All contributions vest immediately on deposit.

97. 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.

98. B — 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 distributions.

99. 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.

100. D — The four hurdles operate in a fixed sequence, and each is tested against the amount that survived the previous one. 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. A loss stopped early never reaches the later hurdles.