

PRACTICE EXAM 20: 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. A retailer has beginning inventory of 82,000 dollars, purchases of 415,000 dollars, withdrew 7,000 dollars of merchandise for personal use, and holds ending inventory of 96,000 dollars. What is cost of goods sold?

- A. Four hundred one thousand dollars, ignoring the personal withdrawal
- B. Four hundred fifteen thousand dollars, equal to the purchases figure
- C. Three hundred ninety-four thousand dollars after all adjustments
- D. Three hundred eighty-seven thousand dollars, deducting twice over

2. Using the figures above with sales of 640,000 dollars, what is gross profit?

- A. Two hundred forty-six thousand dollars for the taxable year
- B. Two hundred thirty-nine thousand dollars after the withdrawal
- C. Two hundred twenty-five thousand dollars on the raw figures
- D. Six hundred forty thousand dollars, before any deduction at all

3. Delia uses 280 square feet of her 2,000 square foot home exclusively as an office. Total home costs are 24,800 dollars. Which method produces the larger deduction?

- A. Both methods produce the identical deduction on these facts

- B. Neither method applies where the space is under three hundred feet
- C. The regular method, allocating fourteen percent of actual costs
- D. The simplified method, at five dollars per square foot

4. Ravi is allocated a 95,000 dollar loss. His outside basis is 70,000 dollars, his at-risk amount is 52,000 dollars, and he has 20,000 dollars of passive income. How much is currently deductible?

- A. Twenty thousand dollars, limited by his passive income
- B. Fifty-two thousand dollars, limited by the at-risk amount
- C. Seventy thousand dollars, limited by his outside basis
- D. Ninety-five thousand dollars, the full amount allocated

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

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

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

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

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

- A. Appreciated real property held previously for investment
- B. A capital interest received in exchange for services rendered
- C. Cash contributed on the formation of the partnership itself

D. Equipment subject to an assumed nonrecourse liability

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

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

9. Which distribution triggers gain to a partner?

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

10. 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. No part of any business continuing to be carried on in partnership form
- D. The expiry of the term stated in the partnership agreement

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

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

12. 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. One hundred percent ownership by the transferring group
- D. Eighty percent of voting power and of each nonvoting class of shares

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

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

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

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

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

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

16. 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

17. 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

18. 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
- C. The corporation must have distributed appreciated property
- D. The corporation must have elected S status within five years

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

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

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

- A. Warehousing of finished goods still awaiting sale to customers
- B. Distribution of completed goods to the purchasing customers
- C. Advertising expenditures promoting the finished product line

D. Research and experimental costs for developing new products

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

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

22. Which discharge produces no cancellation of indebtedness income?

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

23. 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

24. Which risk attends compensation 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

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

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

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

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

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

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

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

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

29. 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

30. 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

31. 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

32. Which item is excluded from qualified business income?

- A. Guaranteed payments received by a partner for services rendered
- 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

33. 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

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

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

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

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

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

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

37. 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 raising no classification issue
- C. Failure to file the required information returns for those workers
- D. Reliance on published judicial precedent covering similar workers

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

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

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

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

40. 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 sole proprietorship, where the owner bears personal liability
- D. A partnership, where liabilities increase each partner's outside basis

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

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

42. 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

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

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

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

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

45. 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

46. Which exemption amount applies to an estate?

- A. Three hundred dollars, matching the simple trust figure
- B. One hundred dollars, matching the complex trust figure
- C. Six hundred dollars for the taxable year in question

D. No exemption is available to an estate at any point

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

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

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

- 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

49. 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

50. 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

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

- A. Breeding hogs kept in the productive herd
- B. Sheep and goats held for breeding and wool
- C. Poultry raised for sale to processors
- D. Cattle and horses held for breeding or dairy purposes

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

- A. Prepaid feed, seed, and fertilizer acquired ahead of season
- B. Soil and water conservation expenditures
- C. Veterinary services for productive breeding stock
- D. Depreciation on field machinery used

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

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

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

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

55. 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 rental use
- C. Utilities and repairs allocable to rental use
- D. Property taxes allocable to rental use

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

- A. A refundable security deposit held on account
- B. A tenant improvement funded for the tenant's own use
- C. Expenses the tenant pays on the landlord's own behalf
- D. The landlord's own maintenance outlay

57. Which disposition releases suspended passive losses in full?

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

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

- A. Fifty percent of gross receipts
- B. Business interest income plus thirty percent of adjusted taxable income
- C. Twenty percent of qualified business income
- D. Interest actually paid rather than accrued

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

- A. On the business schedule as an expense
- B. On Schedule SE before computing the tax
- C. As an adjustment to income on the front of the individual return

D. As an itemized deduction on Schedule A

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

- A. Enrolment through the small business health options marketplace
- B. At least twenty-five equivalent workers
- C. Payment of the entire premium for all employees
- D. Availability across unlimited years

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

- A. Each tests the original allocated loss
- B. Passive activity rules precede the basis test
- C. Each is tested against the amount surviving the previous hurdle
- D. The excess business loss cap comes first

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

- A. Genuine ownership of a capital interest, however acquired
- B. Contribution of substantial services
- C. Acquisition by purchase for full consideration
- D. Attainment of the age of majority

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

- A. It is respected as an arm's length sale
- B. It terminates the partnership for tax purposes
- C. It requires a new identification number
- D. It is treated as a gift for family partnership purposes

64. Which excise tax reaches private foundations but not public charities?

- A. A tax on unrelated business income earned
- B. A tax on failure to distribute a minimum amount annually
- C. A tax on reasonable officer compensation
- D. A tax on gifts from a single major donor

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

- A. It must produce net income not a loss
- B. It must involve sales of tangible merchandise
- C. The activity must be regularly carried on by the organization
- D. It must be conducted outside the state

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

- A. An owner of fifty percent or more of the sponsoring employer
- B. Any participant who holds an account balance within the plan
- C. Any beneficiary named to receive plan benefits upon death
- D. Any vendor supplying goods or services to the employer

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

- A. Two years from the close of the year
- B. One year, matching the ordinary deferral
- C. Three years, as with condemned realty
- D. Four years, extendable where drought persists regionally

68. Which taxpayer may elect farm income averaging?

- A. An individual partner reporting farm income on a Schedule K-1
- B. A C corporation growing commercial crops
- C. An exempt organization running a farm station
- D. A trust leasing farmland to a tenant

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

- A. Ownership of ten percent of each activity
- B. More than half of personal services in real property businesses
- C. Active participation in management annually
- D. Licensure as an agent within the state

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

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

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

- A. Allocation across all days in the year
- B. Allocation by relative fair rental value
- C. Allocation using the total days the property was actually used
- D. Allocation entirely to the rental use

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

- A. It follows its contractual term where shorter
- B. It is deducted in full in the acquisition year
- C. It is recovered only on business disposal

D. It is amortized over fifteen years regardless of actual life

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

- A. Each activity is computed separately with no cross-offsetting
- B. Activities are combined into one computation
- C. Only the most profitable need be reported
- D. Losses may offset exempt function income

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

- A. Adjusted basis at the close of the year
- B. The unadjusted basis of qualified property immediately after acquisition
- C. Fair market value at the acquisition date
- D. Accumulated depreciation claimed to date

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

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

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

- A. A discretionary corpus distribution
- B. A distribution within sixty-five days of year end
- C. Any distribution actually paid in the year
- D. Income required to be distributed currently under the instrument

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

- A. Distribution of any amount to a beneficiary
- B. Any taxable income for the year, whatever the gross amount
- C. Assets exceeding six hundred dollars in value
- D. More than one beneficiary named in it

78. 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. Management fees on rental property held for investment
- D. Fiduciary fees that would not have arisen but for the trust

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

- A. The disallowed excess is permanently lost
- B. It precedes the basis and at-risk limitations
- C. The disallowed excess becomes a net operating loss carryforward
- D. It applies to corporations identically

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

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

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

- A. An excise tax on the amount involved
- B. Contributions suspended for three years
- C. The entire account ceases to be an arrangement that year
- D. A ten percent penalty on the balance

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

- A. Five-year cliff or ten-year graded vesting
- B. Immediate full vesting in every circumstance
- C. Vesting only at normal retirement age
- D. Three-year cliff vesting or six-year graded vesting

83. 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 first year end
- C. Thirty-six months from commencing operations
- D. Six months from adopting the document

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

- A. Fertilizer applied to growing crops
- B. Soil and water conservation expenditures on farmland
- C. Prepaid feed acquired before the season
- D. Repairs to field machinery used

85. 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 each year

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

- A. Gross receipts for the taxable year
- B. Adjusted gross income before the deduction
- C. Total basis of property placed in service
- D. Aggregate taxable income from the active conduct of any business

87. Which schedule analyses unappropriated retained earnings?

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

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

- A. Ordinary losses from an active trade
- B. Depreciation on business property held
- C. Capital losses in excess of capital gains for the year
- D. Wages paid during the loss year

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

- A. Passive income over half of receipts
- B. Accumulated earnings and profits from prior C corporation years
- C. Five shareholders holding a majority
- D. An election made in the past three years

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

- A. An allowance for doubtful accounts
- B. Accelerated depreciation over book
- C. Warranty reserves accrued for reporting
- D. Life insurance proceeds received on a key employee policy

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

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

92. 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

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

- A. A cash distribution received in the year
- B. A decrease in the share of liabilities
- C. The partner's distributive share of tax-exempt income
- D. The share of nondeductible expenses

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

- A. Each tests the original allocated loss
- B. Passive rules precede the at-risk rules
- C. Each hurdle is tested against the amount surviving the previous one
- D. The business loss cap precedes basis

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

- A. Cash in ordinary operating accounts
- B. Depreciation recapture potential embedded in partnership equipment
- C. Land held for capital appreciation
- D. Securities held as long-term investment

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

- A. A partnership under the centralized regime
- B. A partnership that has not elected out
- C. A partnership with over one hundred K-1s
- D. An S corporation correcting an error on a prior return

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

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

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

- A. A tax shelter, regardless of its gross receipts
- B. A personal service corporation in law
- C. A farming corporation with small receipts

D. A service business without inventories

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

- A. Fifty or fewer partners for the year
- B. Advance written consent from the Service
- C. Existence for three or more years
- D. Every partner must be an eligible type of person

100. Which condition terminates a partnership under current law?

- A. A transfer of half the interests yearly
- B. No part of any business continuing in partnership form
- C. Disposing of substantially all assets
- D. Expiry of the agreement's stated term

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1. C — Beginning inventory plus purchases less the personal withdrawal less ending inventory gives three hundred ninety-four thousand dollars. Merchandise removed for personal use must reduce purchases rather than being deducted as a business expense. Omitting that adjustment overstates cost of goods sold by seven thousand dollars and understates gross profit by exactly the same amount.

2. A — Gross profit is sales less cost of goods sold, giving two hundred forty-six thousand dollars. Note that gross receipts of six hundred forty thousand is the figure measured against the statutory thresholds governing accrual accounting, inventories, and capitalization. Cost of goods sold never reduces gross receipts for those threshold tests at all.

3. D — The regular method allocates fourteen percent of twenty-four thousand eight hundred dollars, giving roughly three thousand four hundred seventy dollars. The simplified method gives two hundred eighty multiplied by five dollars, or one thousand four hundred. The regular method is substantially better here, though it requires tracking actual costs and reduces basis through depreciation.

4. B — The hurdles run in sequence and each tests only what survived the previous one. Basis caps the loss at seventy thousand, at-risk then caps it at fifty-two thousand, and the passive limitation finally caps

it at twenty thousand. Twenty-five thousand is suspended by basis, eighteen thousand by at-risk, and thirty-two thousand by the passive rules.

5. C — A domestic eligible entity with two or more members defaults to partnership classification where no election is filed. Disregarded treatment reaches only single-member domestic entities. A state-law corporation is a per se corporation with no election available. A foreign entity with universal limited liability defaults instead to corporate treatment. The foreign rules invert the domestic logic on this point.

6. D — A new number is required only where a genuinely new entity comes into existence. 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. Membership changes, name changes, and relocations all leave the same taxpayer in place.

7. B — 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 generally not taxable on receipt.

8. A — A nonrecourse liability, for which no partner bears 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.

9. A — 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 it happens to be. Marketable securities are generally treated as money for this rule. Distributing publicly traded stock can therefore produce gain where distributing land cannot.

10. C — 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 at all.

11. B — Electing out requires both that the partnership furnish one hundred or fewer Schedules K-1 and that every partner be an eligible type of person. Trusts, partnerships, disregarded entities, and nominees are all ineligible. A single ineligible partner defeats the election however small the partnership. Notification to each partner is required within thirty days.

12. D — Control requires at least eighty percent of the total combined voting power of all classes entitled to vote, and eighty percent of the total number of shares of each other class. Both prongs must hold at the same moment. The second is measured by share count rather than value, and failing either defeats the exchange.

13. A — 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 qualifies for nonrecognition. Boot triggers gain equal to the lesser of realized gain or boot received, and loss is never recognized.

14. D — Tax-exempt interest is cash genuinely received and increases earnings and profits despite never entering taxable income. Life insurance proceeds and the dividends received deduction operate the same way. Federal income taxes, fines, and life insurance premiums are all real outlays reducing genuine capacity to distribute to shareholders. The measure gauges economic capacity rather than taxable income.

15. B — Eligible shareholders are limited to individuals who are citizens or resident aliens, estates, certain qualifying trusts, and some exempt organizations. Partnerships and corporations may never hold shares. A single ineligible shareholder terminates the election on the day the disqualifying transfer occurs. Eligibility is continuous rather than tested once. A later change in residence status terminates the election too.

16. 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 until it is called and the shareholder actually pays. Pledging collateral and corporate third-party borrowing are likewise insufficient.

17. D — 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 shareholders. Ordinary income, separately stated income, and recognized gains all increase the balance. Distributions reduce it only as far as zero, never below.

18. B — The tax reaches only appreciation economically present at conversion from C to S status, 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. Only post-conversion appreciation escapes the corporate layer entirely.

19. C — 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, and it also determines exemption from inventory accounting and capitalization. Crossing the threshold engages all three regimes at once.

20. A — Storage and warehousing of goods before sale is an indirect cost requiring capitalization. Purchasing, handling, quality control, production depreciation, and allocable overhead are treated identically. Selling, advertising, distribution to customers, and research and experimentation all remain currently deductible period costs. The line is whether goods still await a buyer. Purchasing and handling costs are likewise capitalized.

21. C — 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 real property financing is the narrow exception available. It reaches real property activities rather than equipment ventures.

22. 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 income. Debt cancelled as a gift produces none either. Forgiveness of an amount that would have been deductible if paid likewise produces nothing at all.

23. 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 excluded rather than forgiven. Depreciable basis may be elected first instead. Both the exclusion and reduction appear on a prescribed form.

24. 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 become dividends, which the corporation cannot deduct while the recipient remains fully taxable. Double taxation falls on precisely the disallowed portion. The S corporation risk reverses entirely.

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

26. C — Where a domestic trip is primarily personal, transportation to and from the destination is entirely nondeductible. Expenses at the destination 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 during it. Foreign travel follows separate allocation rules entirely.

27. D — 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. Meals at company-wide events and meals included in wages remain fully deductible instead. Bundled invoices defeat the food deduction completely.

28. A — An accountable plan requires a business connection, substantiation within a reasonable period, and return of any excess advance. Allowing employees to keep unspent advances defeats the third condition entirely. Failure of any single condition converts the whole arrangement for every participant. All payments then become taxable wages. Employee business deductions are suspended, so no offset survives.

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

30. D — Section 1245 recaptures all depreciation allowed or allowable as ordinary income before any Section 1231 treatment becomes available. The ordinary component equals the lesser of total depreciation claimed or total gain realized. Real property follows the gentler Section 1250 rule, which

usually recaptures nothing under current methods. Only the residual balance receives Section 1231 netting treatment.

31. 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. Equipment, vehicles, livestock, and partnership interests are excluded in every circumstance. Material describing equipment trade-ins reflects repealed law. Improved property may be exchanged for unimproved property.

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

33. 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 and lose it above the threshold. Their absence is notable given comparable provisions elsewhere.

34. B — Losses arising after 2017 carry forward indefinitely with no carryback, except two years for qualifying farming losses. The deduction is capped at eighty percent of taxable income computed without the loss and without the qualified business income deduction. Pre-2018 losses are used first without any limitation. A large carryforward cannot eliminate a year's liability entirely.

35. C — 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 borne. Bad debt allowances, accelerated depreciation, and warranty reserves all reverse in later periods and affect only timing. Temporary differences affect only when tax is paid overall.

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

37. C — 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 each supply acceptable grounds for reasonable basis. The reporting condition defeats most claims in actual practice.

38. B — 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 first. No intent to defraud is required for the penalty to apply.

39. A — 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 entirely. General records run three years and employment records four.

40. D — A partner's share of partnership liabilities increases outside basis whenever the lender happens to be, supporting early loss deductions in a leveraged venture. An S corporation shareholder gains basis only from a direct loan. C corporation losses trap at entity level and never reach the shareholders. That contrast drives many practical entity selection decisions.

41. C — 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. A seller of heavily depreciated equipment can owe substantial tax before collecting meaningful proceeds from the buyer. The timing mismatch is a recurring installment sale trap.

42. 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 monthly. Equivalents are part-time hours divided by one hundred twenty. Part-time employees establish status but are never owed coverage. Equivalents are computed monthly and added to the count.

43. A — 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, becoming a separate taxable entity only upon the grantor's death. Its income and deductions are reported directly by the grantor.

44. B — Capital gains allocable to corpus are subtracted because they belong to the remainder beneficiary rather than the income beneficiary. The distribution deduction and the personal exemption are added back. Tax-exempt income net of allocable expenses is then added, producing a figure approximating distributable income. Corpus gains belong to the remainder beneficiary instead.

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

46. C — 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. That makes them among the few figures safely memorized regardless of year. Estates enjoy the largest of the three statutory exemptions.

47. B — 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 dedicate assets on dissolution. Both tests must be satisfied independently, and neither alone suffices to establish exempt status. The document must avoid empowering substantial non-exempt activity.

48. 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 provided it is not substantial. Unrelated business activity produces tax rather than revocation unless it becomes primary. Primary purpose marks where tax becomes outright revocation.

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

50. C — 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. A simplified employee pension may instead be established and funded as late as the extended return due date, making it the post-year-end option. No extension of that October deadline is available at all.

51. 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. Animals held primarily for sale remain ordinary income property.

52. A — 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 with indefinite carryforward. That separate limit carries an indefinite carryforward of excess.

53. 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 material participation standards instead. A materially participating lodging operator may deduct losses.

54. B — 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. A management company handling operations does not defeat it.

55. 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 before expenses do. That sequencing favours the taxpayer, since depreciation reduces basis only to the extent actually deducted. The disallowed amount carries forward.

56. C — 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. Lease cancellation payments are likewise income when received.

57. D — 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.

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

59. C — 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 for employees are properly a business expense. One plan produces deductions in two places. Contributions for employees are properly a business expense.

60. A — 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. The credit phases out as headcount or average wages climb.

61. C — 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 one. The final excess becomes a carryforward.

62. A — 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 at all. Where capital is not material, genuine services are required instead.

63. D — 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, and it does not.

64. B — 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 bear the unrelated business income tax. Both categories nevertheless bear that particular tax alike.

65. C — Three elements must all be present: a trade or business, regularly carried on, and not substantially related to the exempt purpose other than through producing funds. A single annual fundraising event is not regularly carried on and escapes the tax. Producing funds alone never establishes substantial relation. A single annual fundraising event escapes the tax on that ground.

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

67. 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 across a region. Livestock held for sale instead qualifies for a one-year deferral of excess proceeds. Purpose of holding determines which of the two reliefs applies.

68. A — 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 entirely unaffected by the election. The election may be made or changed on an amended return later.

69. B — 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.

70. B — 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 at all. Below it a rental loss may still be claimed.

71. 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. Examination answers follow the Service method unless directed otherwise. The two methods produce materially different rental loss figures.

72. 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 one where others from the same acquisition are retained. The disallowed loss attaches to the retained intangibles' basis.

73. A — 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 activity's future income. This prevents sheltering profitable operations behind unprofitable ones. Losses carry forward within their own separate activity silo.

74. B — Qualified property is measured at unadjusted basis immediately after acquisition, meaning original cost without reduction for depreciation. It counts only where 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 larger limb controls. The taxpayer claims whichever of the two limbs produces more.

75. 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 and subtracted too. Both categories move in opposite directions on the schedule.

76. D — 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 taxed even where the trustee failed to make the payment. Second-tier discretionary amounts are taxed only afterward.

77. B — 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. Estates apply only the gross income test.

78. D — 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 fall outside the carve-out. Probate costs and preparation fees also fall inside the carve-out.

79. C — 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, subject there to the eighty percent limitation instead. A loss stopped early never reaches the later hurdles at all.

80. A — 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 all delinquent returns. The rule catches the smallest organizations most often of all.

81. 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 only the amount involved. This is dramatically harsher than the excise tax applying to a qualified plan. Prompt correction does not cure it.

82. 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. Top-heavy plans require accelerated vesting beyond these baselines. Employer contributions are the only ones following any schedule.

83. 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. The application remains valid; only its date shifts. A taxable gap covers the intervening period of operation.

84. B — 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 with indefinite carryforward. Only land actually used in farming qualifies for the deduction.

85. 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.

86. D — 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 generate a loss. Disallowed amounts nevertheless carry forward indefinitely.

87. A — 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 during the year. For an S corporation it tracks distribution taxability instead.

88. C — 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 received that year. Personal deductions therefore cannot generate a business carryover.

89. 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 faces no exposure whatever its investment holdings. Three consecutive years above the threshold are also required.

90. D — Life insurance proceeds are book income that is never taxable, so the difference never reverses and changes the effective rate borne. Bad debt allowances, accelerated depreciation, and warranty reserves all reverse in later periods. Those are temporary differences affecting only when tax is ultimately paid. Permanent differences change the effective rate borne overall.

91. A — 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 cannot be claimed while higher earnings are shown to a lender. The election applies until the Service consents to a change of method. Lower of cost or market may not be combined with the method.

92. 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 that basis returns.

93. C — Tax-exempt income increases outside basis even though it is never taxed, preserving the exemption when the interest is disposed of. Nondeductible noncapital expenses form the exact mirror image, reducing basis despite producing no deduction. Both rules ensure disposition gain reflects economic rather than taxable results. Distributions and liability decreases both reduce outside basis.

94. C — 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 becomes a net operating loss carryforward to the following year. A loss stopped at any hurdle never reaches the next one.

95. B — The definition of unrealized receivables reaches beyond conventional receivables to capture depreciation recapture potential in depreciable property. A partnership holding heavily depreciated equipment therefore carries hot assets. That portion of gain becomes ordinary income rather than the capital gain a sale would otherwise produce. Even a partnership without conventional receivables carries them.

96. D — A partnership subject to the centralized regime cannot amend and must file an administrative adjustment request instead. Adjustments reach partners through statements rather than corrected Schedules K-1. An S corporation may amend in the ordinary way, as may a partnership that has validly elected out of it. Timing and procedure differ from an ordinary amended return.

97. C — 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. Tax-exempt income net of allocable expenses is then added, producing a figure approximating distributable income. Corpus gains belong to the remainder beneficiary instead.

98. 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 for a taxpayer. That threshold also governs inventory accounting and capitalization.

99. D — 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. A single ineligible partner defeats the election however small the partnership happens to be. The partnership must also notify each partner within thirty days.

100. B — Termination now occurs only where no part of any business, financial operation, or venture continues to be carried on by any partner in a partnership. Technical termination on a fifty percent transfer has been repealed entirely. Ownership changes no longer close the tax year or restart depreciation schedules. A two-partner buyout is the common terminating fact pattern.