PRACTICE EXAM 22: 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. Tomasz receives a 60,000 dollar guaranteed payment and is allocated a 45,000 dollar distributive share of ordinary income. What does he report?

A. One hundred five thousand dollars, both amounts being ordinary income
B. Sixty thousand dollars only, the distributive share being a distribution
C. Forty-five thousand dollars only, the guaranteed payment being a draw
D. One hundred five thousand dollars, but only the share is self-employment income

2. A shareholder transfers Property A with a 30,000 dollar basis and 50,000 dollar value, plus Property B with a 45,000 dollar basis and 40,000 dollar value, receiving stock and 18,000 dollars of boot. What gain is recognized?

A. Eighteen thousand dollars, equal to the total boot received
B. Twenty thousand dollars, the gain on the appreciated property
C. Ten thousand dollars, computing each property separately
D. Fifteen thousand dollars, netting the two properties together first

3. What accumulated earnings credit applies to a corporation whose principal function is performing legal services?

A. One hundred fifty thousand dollars, the reduced service amount
B. Two hundred fifty thousand dollars, the general corporate amount
C. No credit at all is available to a service corporation
D. An amount determined solely by its working capital requirements

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

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

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

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

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

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

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

A. Allocation according to the partners' shares of partnership profits
B. Allocation to the single partner bearing the economic risk of loss
C. Allocation equally among all general and limited partners alike

D. Allocation in proportion to each partner's ending capital account

8. Which distribution triggers gain to a partner?

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

9. Which condition terminates a partnership under current law?

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

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

A. The partnership must obtain advance written consent from the Service
B. Every one of its partners must be an eligible type of person
C. The partnership must have fifty or fewer partners for the year
D. The partnership must have been in existence for three or more years

11. Which requirement defines control for Section 351 purposes?

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

12. 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 entitlements
D. Additional shares received later through an ordinary stock split

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

22. 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 outstanding equipment loan
C. A supplier forgiving a trade payable owed by a solvent business
D. A lender reducing principal on an operating credit facility

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

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

24. Which risk attends compensation in a closely held C corporation?

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

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

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 in each calendar month
C. Requiring receipts for expenditures below a stated dollar amount
D. Reimbursing meals at the fifty percent deductible statutory rate

29. 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 installed
D. Qualified improvement property within a commercial building

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

A. Only the portion attributable to bonus depreciation claimed
B. All depreciation previously allowed or allowable on that asset
C. Only depreciation claimed in excess of the straight line amount
D. None, because equipment produces Section 1231 gain entirely

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

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

32. Which item is excluded from qualified business income?

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

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

A. An accounting firm preparing tax and audit engagements
B. A consulting practice advising corporate management clients
C. An engineering firm providing structural design services

D. A brokerage firm dealing in securities for its own clients

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

42. Which figure determines applicable large employer status?

A. Full-time employees plus full-time equivalents in the preceding year
B. Full-time employees counted on the final day of the current year
C. Total employees appearing on the payroll at any point in the year
D. Full-time employees averaged across the current calendar 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 the trustee's discretion
C. A simple trust distributing all of its income currently each year
D. An electing small business trust holding operating company shares

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

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

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

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

46. Which exemption amount applies to an estate?

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

D. Three hundred dollars, matching the simple trust figure

47. 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 its funding
D. The commensurate test applied to program expenditure levels

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

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

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

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

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

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

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

A. Breeding hogs maintained within the productive herd
B. Sheep and goats held for breeding and wool production
C. Poultry raised for eventual sale to processing plants
D. Cattle and horses that are held for breeding or dairy purposes

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

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

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

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

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

A. Material participation exceeding five hundred hours in the year
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

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

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

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

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

57. Which disposition releases suspended passive losses in full?

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

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

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

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

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

D. As an adjustment to income on the front of the individual return

60. 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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

68. 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

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

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

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 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
D. Personal use exceeding one half of the days the property was rented

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

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

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

A. It is amortized over its stated contractual term where shorter
B. It is deducted in full in the year the intangible is acquired
C. It is amortized over fifteen years regardless of its actual life

D. It is recovered only upon disposition of the entire business

73. 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

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

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

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

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

76. Which item is a separately stated item on a partnership return?

A. Utilities consumed at the partnership's operating premises
B. Rent paid for equipment used in ordinary daily operations
C. Section 179 expense elected on qualifying business property
D. Wages paid to non-partner employees during the year

77. Which partner's distributive share is generally excluded from self-employment income?

A. A general partner's share of trade or business income
B. A limited partner's share of trade or business income
C. A guaranteed payment received for services actually rendered
D. A general partner's share of separately stated items

78. Which item may convert an abandonment loss from ordinary to capital?

A. Relief from any share of partnership liabilities on abandonment
B. The partnership's use of the accrual method of accounting
C. The partner's status as limited rather than general
D. The length of time the interest was held before abandonment

79. Which basis rule applies to property acquired by gift and later sold at a loss?

A. The donor's basis governs the loss computation in all cases
B. Fair market value at the gift date governs in every case
C. The donee elects whichever basis produces the larger loss
D. A special rule may produce neither gain nor loss on the sale

80. Which condition permits a corporation to deduct a bonus accrued to an unrelated employee?

A. Payment before the last day of the accrual year itself
B. Written approval by every shareholder of the corporation
C. Payment within two and a half months after the year closes
D. Inclusion of the amount in the employee's prior year wages

81. Which convention applies to residential rental property?

A. The half-year convention applied to most personal property
B. The mid-quarter convention where the threshold is exceeded
C. The mid-month convention regardless of the placement date
D. A full-year convention because the period exceeds ten years

82. Which election applies to an entire class of property rather than asset by asset?

A. The Section 179 expensing election on qualifying property
B. The election to capitalize rather than deduct a repair cost
C. The election to use the installment method on a sale
D. The election out of bonus depreciation for the taxable year

83. Which item reduces qualified business income for a partner?

A. Guaranteed payments received by that partner for services
B. Ordinary business income allocated on the Schedule K-1
C. Section 1231 gain treated as long-term capital gain
D. Interest income allocable to the partnership's business

84. What is the applicable percentage used within the qualified business income phase-in range?

A. The ratio of qualified income to total taxable income
B. The proportion of the way through the phase-in range
C. A flat fifty percent applied throughout the entire range
D. The ratio of W-2 wages to qualified business income earned

85. Which credit component covers part of the cost of establishing a new qualified plan?

A. The work opportunity credit for targeted group hires
B. The employer credit for social security taxes on tips
C. The small employer pension plan startup costs credit

D. The disabled access credit for accessibility expenditures

86. Which technique tests whether reported business receipts are complete?

A. Verifying that the balance sheet columns foot correctly
B. Comparing business-source deposits to reported gross receipts
C. Reconciling depreciation to the detailed fixed asset ledger
D. Confirming retained earnings ties to the prior year figure

87. Which change requires consent on Form 3115 rather than an amended return?

A. A mathematical error in computing one year's depreciation
B. A transposition error in reporting gross receipts once
C. An omission of a single deductible expense in one year
D. An impermissible treatment applied consistently across two returns

88. Which protection does voluntarily filing a method change request generally provide?

A. Audit protection for the earlier years that were affected
B. Elimination of any adjustment for prior taxable years
C. A refund of tax overpaid under the former method
D. Waiver of the user fee otherwise payable on request

89. Which arrangement is respected where a business leases property from its own owner?

A. One where rent is set below market to reduce entity income
B. One where no written lease documents the arrangement
C. One where rent varies with the entity's annual profits
D. One where the rent charged is reasonable in amount

90. Which item is included in gross receipts without reduction?

A. Amounts received before any deduction, including cost of goods sold
B. Amounts remaining after cost of goods sold is subtracted
C. Net profit after all operating expenses are deducted
D. Amounts collected in cash but excluding accrued receivables

91. Which item is a temporary book-tax difference?

A. Tax-exempt interest earned on municipal bond holdings
B. Fines paid for violating a regulatory requirement
C. An installment sale gain recognized fully for book purposes
D. Life insurance premiums where the entity is beneficiary

92. Which condition must be satisfied for an involuntary conversion to qualify for gain deferral?

A. The replacement property must be real property in every case
B. The proceeds must be reinvested in qualifying replacement property
C. The taxpayer must have held the property for over one year
D. The conversion must have resulted from a government condemnation

93. Which loss may an individual carry back rather than only forward?

A. A general business loss from an active trade or business
B. A farming loss, subject to a two-year carryback period
C. A passive activity loss suspended in the current year
D. An excess business loss disallowed under the annual cap

94. Which requirement applies to listed property substantiation?

A. A summary reconstructed at the close of the taxable year
B. Approval of the mileage by a supervisor or officer
C. Records of the amount, time, place, and business purpose
D. Retention of fuel receipts for every trip undertaken

95. Which deposit obligation arises where accumulated employment tax liability reaches a hundred thousand dollars?

A. Deposit by the next business day following that day
B. Deposit within three business days of reaching the amount
C. Deposit by the fifteenth day of the following month
D. Deposit together with the quarterly return when filed

96. Which item must a partnership report to its partners by liability category?

A. The partnership's total assets at the close of the year
B. Each partner's share of gross receipts for the year
C. The partnership's aggregate depreciation for the year
D. Each partner's share of recourse and nonrecourse liabilities

97. Which statement about a personal service corporation is correct?

A. It may adopt any fiscal year without establishing a purpose
B. It is exempt from the accumulated earnings tax entirely
C. It receives an enhanced accumulated earnings credit amount
D. It is confined to a calendar year absent a business purpose

98. Which condition must be met for an accountable plan reimbursement to be excluded from wages?

A. Substantiation within a reasonable period and return of excess
B. Payment of the reimbursement within the same calendar quarter

C. Approval of each expenditure by an officer before payment
D. Reimbursement at a rate not exceeding the federal per diem

99. Which item is excluded from inventoriable cost for a reseller?

A. Freight charges incurred in acquiring the merchandise
B. Purchasing department costs allocable to acquisitions
C. Shipping supplies used to deliver goods out to customers
D. Handling and repackaging of goods held for sale

100. Which statement about percentage depletion is correct?

A. It may never exceed the property's remaining adjusted basis
B. It may continue after the property's basis is fully exhausted
C. It is available for timber but not other natural resources
D. It is computed by allocating basis over recoverable units

Practice Exam 22: Answer Key and Explanations

1. A — Both amounts are ordinary income to the partner and both are generally self-employment income to a general partner. The partnership deducts the guaranteed payment where the underlying expense is deductible, so the distributive share is already computed after that deduction. Reporting only one of the two figures understates income by the other.

2. D — Boot is allocated by relative fair market value and the lesser-of computation runs separately on each property. Property A receives ten thousand of boot against twenty thousand of realized gain, recognizing ten thousand. Property B has a realized loss, so its eight thousand of boot produces nothing. Netting the properties first gives a wrong figure.

3. B — The credit is reduced to one hundred fifty thousand dollars for corporations whose principal function is performing services in health, law, engineering, architecture, accounting, actuarial science, the performing arts, or consulting. All other corporations receive two hundred fifty thousand. The credit is a floor below which accumulations are presumptively acceptable.

4. 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 at all. A foreign entity with universal limited liability defaults instead to corporate treatment.

5. C — 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.

6. A — 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.

7. B — 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.

8. D — 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.

9. 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. A two-partner buyout is the common pattern.

10. C — 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.

11. 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.

12. 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.

13. C — 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.

14. A — 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.

15. D — 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.

16. B — 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.

17. A — 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.

18. D — 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.

19. C — Merchandise removed for personal use must be subtracted from purchases rather than deducted as a business expense. Treating it as an expense overstates cost of goods sold and understates gross profit by that same amount. Freight is instead added into inventoriable cost. Trade discounts reduce the invoice price directly. The withdrawal is a personal item rather than a business cost.

20. B — 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 into inventory.

21. D — 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. B — 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. A — 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. C — 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. Foreign travel follows separate rules.

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. Bundled invoices defeat the food deduction.

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 without offset. All payments then become taxable wages without any offset.

29. B — 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. C — 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. A — 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. D — Guaranteed payments are excluded on the same reasoning that excludes S corporation reasonable compensation, both being payments for services rather than a share of 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. B — 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 upper threshold. Their absence is notable given comparable provisions elsewhere.

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

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

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

40. A — A partner's share of partnership liabilities increases outside basis whoever the lender happens to be, supporting early loss deductions in a leveraged venture. An S corporation shareholder gains basis only from a direct loan. C corporation losses trap at entity level and never reach the shareholders at all. 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. 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 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. 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 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. C — 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. D — 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. 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 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. B — 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 the primary purpose. 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. A — The savings incentive match plan must generally be established by October first for the year it is to be effective, and that deadline carries no extension. 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. C — Prepaid farm supplies are limited to fifty percent of other deductible farm expenses for the year. Exceptions apply for farmers meeting a substantial-business test or where unusual circumstances caused the excess. Soil and water conservation expenditures face a separate twenty-five percent of gross farm income limit with indefinite carryforward. That separate limit carries an indefinite carryforward of excess.

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

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

56. A — Expenses the tenant pays on the landlord's behalf are rental income when received. So are rents, advance rent, lease cancellation payments, and the 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. B — 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. A — The cap is the sum of business interest income, thirty percent of adjusted taxable income, and floor plan financing interest. Disallowed amounts carry forward indefinitely to later years. A taxpayer meeting the gross receipts test governing accrual accounting and capitalization is exempt from the limitation entirely. Floor plan financing interest is added into the same cap.

59. D — 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 therefore produces deductions in two places. Contributions for employees are properly a business expense.

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

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

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

69. D — Both conditions must hold in the same taxable year. More than half of all personal services performed in any trade or business must be in real property trades or businesses in which the taxpayer materially participates. More than seven hundred fifty hours must be devoted to those businesses. Licensure and ownership percentage form no part of the test.

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 be claimed by the owner.

71. A — 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 loss figures.

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

74. D — 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. A — 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. C — Section 179 expense is separately stated because the election and its dollar and income limitations operate at the partner level as well as the entity level. Utilities, rent, and ordinary wages carry no partner-level variation. They are aggregated into ordinary business income on page one of the return instead. The Its limitations operate at the partner level too.

77. B — A limited partner's distributive share is generally excluded from self-employment income, while a general partner's share of trade or business income is included in full. Guaranteed payments for services remain subject to the tax for either type of partner. That asymmetry is exactly what these questions are built to test.

78. A — Abandonment ordinarily produces an ordinary loss because it is not a sale or exchange. Relief from even a small share of partnership liabilities converts the transaction into a deemed sale or exchange, making the loss capital. Questions in this area invariably turn on whether the partnership had liabilities outstanding. The Questions here invariably turn on whether liabilities were outstanding.

79. D — Gifted property takes the donor's basis for computing gain and the lower of that basis or value at the gift date for computing loss. Where the property sells between those two figures, the special rule produces no gain and no loss at all. Candidates frequently overlook that outcome entirely. The dual-basis rule produces this unusual middle-ground outcome.

80. C — An accrual employer may deduct a bonus declared before year end and paid within two and a half months afterward, provided the liability was fixed and determinable at year end. The rule is unavailable where the recipient is a related party, in which case the deduction awaits the recipient's inclusion.

81. C — Residential rental and nonresidential real property both use the mid-month convention regardless of when in the month the property was placed in service, and both are always straight line. Personal property uses the half-year convention by default, replaced by mid-quarter where the fourth-quarter threshold is exceeded. Personal property instead uses the half-year convention.

82. D — Bonus depreciation applies automatically and is elected out of by class rather than asset by asset. A taxpayer wanting to expense some assets and depreciate others therefore needs the granularity of Section 179, which is elected affirmatively and may cover partial amounts of a single asset. The Section 179 alone permits asset-by-asset and partial elections.

83. A — Guaranteed payments are excluded from qualified business income on the same reasoning excluding S corporation reasonable compensation: both are payments for services rather than a share of business profits. The partnership's deduction for the payment correspondingly reduces the ordinary income that does qualify for the deduction. The partnership's deduction reduces qualifying ordinary income.

84. B — The applicable percentage measures how far through the phase-in range the taxpayer sits. That percentage is multiplied by the excess amount, being the difference between the tentative deduction and the fully applied wage limit. The product is then subtracted from the tentative deduction rather than from income. The phase-in produces a partial rather than total disallowance.

85. C — The credit covers a portion of the costs of establishing a new qualified plan, with an additional component for automatic enrolment features. It has become considerably more generous and is frequently overlooked. Like other components it shares the general business credit's single limitation and carryover regime. Component credits share one limitation and carryover regime.

86. B — Removing documented non-income deposits such as loan proceeds and owner transfers, then comparing the remainder against reported receipts, exposes income that never reached the books. A cash rollforward that ties proves only internal consistency of what was recorded, not completeness of the record itself. The Loan proceeds and owner transfers must be removed before comparing.

87. D — A method of accounting requires consistent treatment across at least two consecutive returns, so a single year's treatment is an error correctable by amendment. An impermissible method once adopted is changed only prospectively with consent, and the cumulative prior-year effect is brought forward as an adjustment. Operational changes are not method changes at all.

88. A — A taxpayer voluntarily changing from an impermissible method generally receives audit protection for earlier years. A taxpayer whose impermissible method is discovered on examination does not, and the Service may impose the change with the entire adjustment falling into a single year rather than spreading over four. The Examination-imposed change offers no such protection at all.

89. D — A self-rental is respected where the rent is reasonable, with the business deducting it and the owner reporting rental income. An inflated or artificial rent between related parties is recharacterized. The passive activity consequences then follow the one-directional self-rental rule treating net income as nonpassive. Net income becomes nonpassive while losses remain passive.

90. A — Gross receipts are the total amounts received or accrued from all sales and services measured before any deduction whatever, including cost of goods sold. Returns and allowances are subtracted separately to reach net sales. Several statutory thresholds are measured against this gross figure averaged across three years. Returns and allowances are subtracted separately afterward.

91. C — An installment gain is recognized in full for book purposes at sale but recognized for tax as payments are received, so the difference reverses over time. Tax-exempt interest, fines, and life insurance premiums where the entity is beneficiary never reverse and are permanent differences affecting the effective rate. Permanent differences change the effective rate borne overall.

92. B — Gain is recognized only to the extent proceeds exceed the cost of qualifying replacement property, so a taxpayer reinvesting everything recognizes nothing. Unlike like-kind exchanges the provision still reaches both real and personal property. The replacement period is two years, extended to three for condemned business realty. The replacement period runs from the close of the year.

93. B — Farming losses retain a two-year carryback, which is the sole surviving exception to the rule that losses arising after 2017 carry forward only. Ordinary business losses, suspended passive losses, and disallowed excess business losses all move forward, the last becoming a net operating loss carryforward. All others move forward without any carryback available.

94. C — The taxpayer must establish the amount of each expense or the mileage, the time and place of travel, and the business purpose, ordinarily through a contemporaneous log. Estimates and reconstructions prepared during an examination carry little weight. A failure to substantiate disallows the deduction entirely rather than reducing it. Business relationship must also be shown where relevant.

95. A — The amount must be deposited by the next business day, and a monthly depositor triggering the rule becomes a semiweekly depositor for the remainder of that year and the following one. Otherwise the schedule is fixed by liability during the lookback period ending the preceding June thirtieth. The lookback period otherwise fixes the deposit schedule.

96. D — The Schedule K-1 reports each partner's share of recourse, qualified nonrecourse, and other nonrecourse liabilities. These figures are substantive rather than informational: they determine outside basis, which determines loss deductibility, so an allocation error flows straight through to a wrong deduction. Recourse and nonrecourse debt follow entirely different rules. An allocation error flows straight through to a wrong deduction.

97. D — A personal service corporation is confined to a calendar year unless it establishes a business purpose for a different one, and a Section 444 election permits at most a three-month deferral with a minimum distribution requirement. It also receives a reduced rather than enhanced accumulated earnings credit. A Section 444 election carries a distribution requirement.

98. A — An accountable plan requires a business connection, substantiation within a reasonable period, and return of any excess advance. Failure of any single condition converts the arrangement to a nonaccountable plan for all participants, making every payment taxable wages with no offsetting employee deduction available. Employee business deductions are suspended under current law.

99. C — Inventoriable cost includes the invoice price less trade discounts plus freight and other acquisition charges. Containers passing to the buyer with the goods are inventoriable, while shipping supplies used for outbound delivery are not. Purchasing, handling, and repackaging costs must all be capitalized into inventory. Containers passing with the goods are inventoriable instead.

100. B — Percentage depletion applies a statutory rate to gross income from the property and may continue after basis is exhausted, which is why it must be tracked separately for earnings and profits purposes. Cost depletion allocates basis over recoverable units and can never exceed basis at all. Cost depletion allocates basis over recoverable units instead.