PRACTICE EXAM 25: 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. An employer pays full state unemployment contributions on time. What net federal unemployment rate applies to the wage base?

A. Six tenths of one percent, after the maximum state credit
B. Six percent, with the state contributions separately deductible
C. Five and four tenths percent, matching the state credit rate
D. No federal tax, because state contributions replace it entirely

2. Listed property used sixty percent for business in year one falls to forty-five percent in year two. What follows?

A. The property is removed from service for tax purposes entirely
B. Only the current year's deduction is reduced proportionately
C. The taxpayer switches to the alternative system and recaptures excess
D. Depreciation simply continues under the original method chosen

3. Which payments to a retiring partner are deductible by the partnership?

A. Payments not made for the partner's interest in partnership property
B. Payments made for the partner's share of the partnership's assets

C. Payments representing the partner's share of unrealized receivables
D. All liquidating payments, whatever their underlying character

4. Contributed property is distributed to a different partner within seven years. What happens to the contributor?

A. The contributor's capital account alone is adjusted downward
B. The contributor recognizes the remaining built-in gain on the property
C. Nothing, because partnership distributions are generally tax free
D. The distributee partner recognizes the built-in gain instead

5. Which stock dividend is taxable to the shareholder?

A. A distribution where shareholders may elect cash instead of shares
B. A pro rata distribution of common shares on common stock held
C. A distribution of additional shares following a routine stock split
D. A distribution increasing every shareholder's holding proportionately

6. When are calendar-year corporate estimated tax installments due?

A. Annually with the return, since corporations pay no estimates
B. On the fifteenth day of the fourth, sixth, ninth, and twelfth months
C. Quarterly on the last day of March, June, September, and December
D. On the fifteenth day of April, July, October, and January following

7. Which power may lapse annually without being treated as a taxable release?

A. A power to withdraw the greater of five thousand dollars or five percent
B. A power to revoke the trust and reclaim the entire corpus
C. A power to direct the beneficial enjoyment of trust income
D. A power to borrow trust corpus without adequate security

8. Which plan design avoids annual deferral percentage testing?

A. A plan requiring three years of service before any participation
B. A plan covering fewer than one hundred eligible employees
C. A safe harbor plan making prescribed fully vested contributions
D. A plan limiting participation to non-highly compensated employees

9. Which asset class receives residual purchase price last in an asset acquisition?

A. Accounts receivable and other debt instruments transferred
B. Goodwill and going concern value transferred with the business
C. Actively traded personal property and marketable securities held
D. Tangible assets such as equipment, vehicles, and buildings

10. Which taxpayer may elect the qualified real property business indebtedness exclusion?

A. Any taxpayer whose discharged debt relates to real property
B. An individual whose personal residence mortgage was reduced
C. A taxpayer other than a C corporation with business realty debt
D. A C corporation holding rental real estate for investment

11. Which reduction follows a qualified real property business indebtedness exclusion?

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

12. Which employer must file the annual rather than quarterly employment tax return?

A. An employer notified by the Service that it qualifies to do so
B. Any employer whose payroll falls below the deposit threshold
C. Any employer with fewer than ten employees during the year
D. An employer paying wages only in the final quarter of the year

13. Which employer obligation arises where employees receive tips?

A. Payment of the employees' entire share of tax on those tips
B. Withholding on reported tips and possible allocation among employees
C. Exclusion of tips from wages for all employment tax purposes
D. Reporting tips only where they exceed the employee's regular wages

14. Which credit is available to a food and beverage employer on tips?

A. A credit equal to income tax withheld on the reported tips
B. A credit for tips paid directly by the employer to employees
C. A credit for the employer's Social Security tax on excess tips
D. A credit for the entire amount of tips reported by employees

15. Which use requires depreciation under the alternative depreciation system?

A. Tangible property used predominantly outside the United States
B. Property acquired secondhand rather than newly manufactured
C. Property financed through a nonrecourse commercial loan
D. Property placed in service during the fourth calendar quarter

16. Which improvement to nonresidential real property qualifies for Section 179 expensing?

A. An elevator or escalator installed within the building

B. Work on the internal structural framework of the building
C. An addition enlarging the total floor area of the building
D. A roof, heating and air conditioning, fire protection, or security system

17. Which consequence follows leasing rather than buying a passenger automobile?

A. An inclusion amount reduces the deduction from a published table
B. The lease payments are fully deductible with no adjustment
C. The depreciation caps apply directly to the lease payments made
D. No deduction is available for a leased business vehicle at all

18. Which event accelerates gain on an installment obligation?

A. The seller's death before the obligation is fully collected
B. The seller reporting the sale on a return filed after its due date
C. The seller pledging the obligation as security for a borrowing
D. The buyer making payments earlier than the contract requires

19. Which item must be separated out of a deferred payment sale price?

A. Interest, imputed at the applicable federal rate where unstated
B. The seller's original acquisition cost of the property sold
C. Any depreciation the seller claimed while holding the property
D. The buyer's expected resale proceeds from the property

20. Which item does a corporation add back in computing earnings and profits for a depreciable asset?

A. The excess of accelerated depreciation over the alternative system
B. Any Section 179 expense deducted in the year of acquisition
C. Any gain recognized on the eventual disposal of the asset
D. The salvage value assigned to the asset when acquired

21. Which stock may produce ordinary income on a later disposition?

A. Preferred stock purchased from an unrelated shareholder
B. Section 306 stock received as a nontaxable preferred dividend
C. Common stock received in a tax-free incorporation exchange
D. Voting stock acquired through an employee purchase plan

22. Which distribution does a corporation treat as a consent dividend?

A. A distribution of property rather than cash to shareholders
B. A distribution made in redemption of a shareholder's stock
C. An amount shareholders agree to treat as received though unpaid
D. A distribution actually paid within two and a half months after year end

23. Which method may a corporation use to lower an early estimated tax installment?

A. The seasonal method, available only to farming corporations
B. The annualized income method, based on income actually earned
C. The prior year safe harbor, available to every corporation alike
D. The averaging method, spreading the annual liability evenly

24. Which trust election allows a trust to hold S corporation stock with income taxed at trust rates?

A. The electing small business trust election covering the S portion
B. The qualified subchapter S trust election by the beneficiary
C. The sixty-five day election accelerating distributions
D. The grantor trust election made by the settlor at formation

25. Which requirement applies to a qualified subchapter S trust?

A. It must have at least two current income beneficiaries
B. It must be revocable by the grantor during their lifetime
C. It must have a single income beneficiary who makes the election
D. It must distribute corpus to the beneficiary within ten years

26. Which organization is a supporting organization rather than a private foundation?

A. One organized and operated to support a specified public charity
B. One receiving all of its funding from a single family donor
C. One holding investment assets and making periodic grants
D. One conducting research without soliciting public contributions

27. Which payment to an exempt organization is a qualified sponsorship payment?

A. A payment where the acknowledgment includes the sponsor's logo
B. A payment contingent on attendance at the sponsored event
C. A payment for advertising comparing the sponsor's products
D. A payment in exchange for a periodical advertisement placed

28. Which gaming activity may still produce unrelated business income?

A. A raffle conducted entirely by unpaid volunteer members
B. Regular gaming conducted with substantially paid employee labour
C. Bingo conducted lawfully where commercial bingo is not permitted
D. An annual charity auction held once in the calendar year

29. Which distribution must a business owner take from a retirement plan?

A. A distribution of the entire balance on ceasing active work

B. Required minimum distributions from the applicable beginning date
C. A distribution beginning in the year the owner reaches age fifty-nine
D. A distribution equal to annual contributions made that year

30. Which rollover method avoids mandatory withholding on a plan distribution?

A. A direct trustee-to-trustee transfer between the two plans
B. An indirect rollover completed within sixty days of receipt
C. A rollover completed before the close of the taxable year
D. A rollover of only the taxable portion of the distribution

31. Which employee may be excluded from a simplified employee pension?

A. One who is covered by another employer's retirement plan
B. One who has not worked in three of the preceding five years
C. One who declines to make elective contributions to the plan
D. One who has been employed for fewer than twelve full months

32. Which farm payment is excluded from self-employment income?

A. Crop share rent received where the landlord materially participates
B. Patronage dividends received from a marketing cooperative
C. Conservation reserve payments received by a taxpayer receiving social security
D. Payments for custom harvesting performed on neighbouring farms

33. Which schedule computes farm income averaging?

A. The self-employment tax schedule attached to the return
B. The farm rental schedule for non-participating landowners
C. The separate averaging schedule applying elected farm income
D. The farm profit and loss schedule used for ordinary operations

34. Which item is a grouping decision under the passive activity rules?

A. Treating multiple business activities as one economic unit
B. Electing to treat all rental activities as non-passive
C. Choosing which year suspended losses become deductible
D. Allocating basis among several activities the taxpayer owns

35. Which interest is recharacterized under the self-charged interest rules?

A. Interest a taxpayer receives on a loan to their own passive activity
B. Interest a taxpayer pays on a mortgage over rental property
C. Interest a taxpayer pays on a loan used to buy an interest
D. Interest a taxpayer receives from an unrelated commercial borrower

36. Which treatment applies to a former passive activity that becomes non-passive?

A. Suspended losses are permanently disallowed on the change
B. Suspended losses offset income from that same activity first
C. Suspended losses are released in full in the year of the change
D. Suspended losses convert into a net operating loss carryforward

37. Which amount triggers at-risk recapture as income?

A. A negative at-risk amount arising after withdrawals exceed exposure
B. Any distribution received from the activity during the year
C. Any loss allocated in excess of the taxpayer's outside basis
D. Any nonrecourse financing obtained after losses were claimed

38. Which financing qualifies as qualified nonrecourse financing for at-risk purposes?

A. Borrowing secured by real property from a qualified commercial lender
B. Borrowing from a person with an interest in the activity itself
C. Borrowing secured by equipment used in the leasing activity
D. Borrowing guaranteed personally by another participating investor

39. Which item is allocated to Class III under the residual method?

A. Inventory and other property held primarily for sale to customers
B. Accounts receivable and other debt instruments of the business
C. Cash held in the acquired business's operating bank accounts
D. Goodwill and going concern value transferred with the business

40. Which item does a partnership report where it holds a foreign financial account?

A. The account on the partnership's own balance sheet schedule only
B. The account only where the balance exceeds one million dollars
C. The account on the foreign bank account report where thresholds are met
D. Nothing, because reporting obligations rest only on individuals

41. Which condition permits a taxpayer to deduct a bad debt as partially worthless?

A. The debt must have been outstanding for more than two years
B. The debt must be a business debt and the amount charged off
C. The debtor must have entered into a formal insolvency proceeding
D. The creditor must have obtained a judgment against the debtor

42. Which item is included in the general business credit carryover ordering?

A. Carryforwards used before the current year's credits arise

B. Carrybacks used only after all carryforwards are exhausted
C. Current year credits used before any carryforward amounts
D. Whichever ordering produces the largest current year benefit

43. Which employer expenditure qualifies for the employer-provided childcare credit?

A. Amounts contributed to a dependent care flexible spending plan
B. The cost of acquiring or operating a qualified childcare facility
C. Wages paid to employees while on approved parental leave
D. Payments to employees to reimburse their own childcare costs

44. Which condition applies to the employer credit for paid family and medical leave?

A. A written policy providing a minimum period of paid leave
B. Participation in a state paid family leave insurance programme
C. Employment of at least fifty full-time equivalent employees
D. Payment of leave at the employee's full ordinary rate of pay

45. Which item does an accrual taxpayer include when inventory shrinkage is estimated?

A. No shrinkage estimate until an actual physical count is taken
B. An estimate where physical counts are taken and the method is consistent
C. The full estimated shrinkage without any physical verification
D. Shrinkage only for the final month of the taxable year

46. Which pooling approach does the dollar-value method use?

A. Grouping of similar items into pools measured in base year dollars
B. Individual tracking of each separate item held in inventory
C. Valuation of the entire inventory at current replacement cost
D. Separate valuation of raw materials, work in progress, and goods

47. Which condition must be met before a taxpayer may use the retail method?

A. The taxpayer must maintain records of the retail selling prices
B. The taxpayer must value all inventory at cost rather than market
C. The taxpayer must obtain advance consent from the Service
D. The taxpayer must sell exclusively to ultimate consumers

48. Which cost may a farmer elect to capitalize rather than deduct?

A. Wages paid to seasonal labour engaged for the harvest
B. Repairs to machinery used across ordinary field operations
C. Preproductive period costs of raising an orchard or vineyard
D. Ordinary feed purchased for livestock during the season

49. Which item does a partnership adjust under Section 734 following a distribution?

A. The basis of the partnership's remaining undistributed property
B. The outside basis of only the distributee partner's interest
C. The capital accounts of all the continuing partners equally
D. The partnership's method of accounting for future years

50. Which condition makes a Section 743 adjustment mandatory without an election?

A. Any transfer of more than half the partnership interests
B. A substantial built-in loss existing at the time of the transfer
C. A transfer occurring within two years of the partnership's formation
D. Any transfer to a person related to the transferring partner

51. Which item does a publicly traded partnership face that others do not?

A. A prohibition on allocating losses to any of its partners
B. A requirement that all partners be individual taxpayers
C. Treatment as a corporation unless the gross income test is met
D. Mandatory conversion into a corporation after ten years

52. Which fringe benefit may a more-than-two-percent S corporation shareholder exclude?

A. Meals and lodging furnished for the employer's convenience
B. Qualified retirement plan contributions made by the corporation
C. Employer-paid group term life insurance coverage provided
D. Employer-paid accident and health insurance premiums

53. Which consequence follows an S corporation redemption failing the exchange tests?

A. The payment is treated as an ordinary distribution to the shareholder
B. The redemption is treated as a sale producing capital gain
C. The corporation recognizes gain on the shares it reacquires
D. The S election terminates because of the ownership change

54. Which item does a trust use the throwback rules to address?

A. Distributions made within sixty-five days after the year ends
B. Accumulated income distributed by certain foreign trusts
C. Distributions of current income exceeding distributable net income
D. Capital gains allocated to corpus rather than to income

55. Which requirement applies to the separate share rule for an estate?

A. Substantially separate and independent shares of different beneficiaries

B. A written direction in the will establishing separate accounts
C. Election by the executor on the first fiduciary return filed
D. Distribution of all income currently to each of the shares

56. Which election affects basis where an estate distributes property in kind?

A. An election by the beneficiary to take a carryover basis instead
B. An election to defer the distribution into the following year
C. An election to allocate the estate tax across the distributed assets
D. An election to treat the distribution as a sale at fair market value

57. Which item is subject to the two percent floor for a trust under current law?

A. Nothing, because the floor is suspended along with those deductions
B. Fiduciary fees incurred solely because property is held in trust
C. Costs of preparing the trust's own fiduciary income tax return
D. Appraisal fees required to value assets for the trust's purposes

58. Which condition must a private foundation satisfy to avoid the excess business holdings tax?

A. Combined foundation and disqualified person holdings within permitted limits
B. Holding no interest whatever in any operating business enterprise
C. Disposal of all business holdings within one year of receiving them
D. Annual valuation of the holdings by an independent appraiser

59. Which expenditure is a jeopardizing investment by a private foundation?

A. A programme-related investment furthering the exempt purpose
B. A diversified portfolio managed by an independent adviser
C. An investment showing a failure to exercise ordinary business care
D. An investment in publicly traded equity securities of large issuers

60. Which item must an exempt organization report about its highest paid staff?

A. Only amounts paid to the chief executive of the organization
B. Only amounts exceeding one million dollars in the year
C. Nothing, because compensation details are always confidential
D. Compensation of officers, directors, trustees, and key employees

61. Which excise tax applies where an exempt organization pays excessive compensation?

A. A tax on the recipient and possibly on the managers approving it
B. A tax on every board member regardless of their involvement
C. No tax applies where the organization corrects the payment
D. A tax on the organization equal to the full excess amount

62. Which requirement supports the rebuttable presumption of reasonable compensation?

A. Advance approval by an authorized body relying on comparability data
B. Approval by a majority of the organization's general membership
C. Certification by the organization's independent outside auditor
D. Publication of the compensation in the organization's annual report

63. Which item is a qualified transportation fringe still excludable to the employee?

A. Reimbursement of the employee's ordinary commuting mileage
B. Transit passes provided within the monthly statutory limit
C. An employer deduction for the cost of employee parking provided
D. A cash allowance provided monthly for travel to work

64. Which condition applies to employer-provided educational assistance?

A. The education must lead to a degree from an accredited institution
B. The employee must remain employed for two years afterward
C. The programme must not discriminate in favour of highly compensated staff
D. The assistance must be provided only to full-time employees

65. Which item does an employer include in wages for a below-market employee loan?

A. Nothing, because loans to employees are never compensatory
B. Imputed interest at the applicable federal rate as compensation
C. The entire principal amount of the loan when it is advanced
D. The difference between the loan and the employee's annual salary

66. Which item is a de minimis fringe benefit excludable from wages?

A. Occasional personal use of the employer's photocopying equipment
B. A season ticket to sporting or theatrical events provided
C. A gift certificate redeemable for general merchandise
D. Membership in a country club paid for by the employer

67. Which condition allows an employer to use the special accounting rule for fringe benefits?

A. Treating benefits provided in November and December as paid next year
B. Reporting all fringe benefits on a calendar quarter basis
C. Excluding benefits below a stated annual dollar threshold
D. Deferring all fringe benefit reporting until the employee terminates

68. Which item must a business report where it acquires a trade or business?

A. Only the total consideration paid without any allocation detail

B. The buyer's intended use of each asset class acquired
C. The asset acquisition statement reporting the price allocation
D. Nothing, since acquisitions are reported only by the seller

69. Which item does an accrual taxpayer treat under the all-events test for income?

A. Income recognized when the customer's payment clears
B. Income recognized when performance is completed regardless of billing
C. Income recognized when the right to receive becomes fixed and determinable
D. Income recognized when the cash is actually received

70. Which condition applies to the recurring item exception for a rebate liability?

A. Economic performance within eight and a half months after year end
B. Payment of the rebate before the close of the taxable year
C. Written confirmation from each customer entitled to the rebate
D. Approval of the rebate programme by the entity's directors

71. Which liability has economic performance only upon payment?

A. A liability for workers compensation or tort claims payable
B. A liability for services the taxpayer has contracted to receive
C. A liability for property the taxpayer has agreed to acquire
D. A liability for the use of property under an executed lease

72. Which item does the transaction cost regulation require to be capitalized?

A. Costs of routine borrowing arranged in the ordinary course
B. Costs facilitating an acquisition after the bright line date
C. Costs of investigating whether to acquire a business generally
D. Costs of employee compensation regardless of the transaction

73. Which item does an employer withhold from a nonresident alien employee differently?

A. Withholding at a flat thirty percent regardless of the wages
B. Withholding computed with special rules adjusting the wage amount
C. No withholding applies to any nonresident alien employee at all
D. Withholding only where a tax treaty specifically requires it

74. Which item must a partnership withhold on for a foreign partner's share?

A. Capital gains from securities held in the partnership's portfolio
B. Any distribution actually made during the taxable year only
C. Effectively connected taxable income allocable to that partner
D. Portfolio interest allocated to that foreign partner's account

75. Which item does a taxpayer report where a foreign corporation is controlled?

A. The information return required of certain United States shareholders
B. Nothing, because foreign corporations file their own returns
C. Only dividends actually received from that foreign corporation
D. Only the taxpayer's proportionate share of foreign taxes paid

76. Which item is included in a corporation's adjusted taxable income for the interest limitation?

A. The entire amount of depreciation regardless of the year
B. Business interest expense added back before applying the cap
C. Capital gains realized on business asset dispositions
D. Dividends received from unrelated domestic corporations

77. Which election permits a real property trade or business to avoid the interest limitation?

A. An irrevocable election requiring the alternative depreciation system
B. An election filed annually with each timely filed return
C. An election available only where gross receipts are under the threshold
D. An election that may be revoked with the consent of the Service

78. Which item is a partner's share of business interest expense subject to?

A. Testing entirely at the partnership level with no partner testing
B. A choice between entity level and partner level testing each year
C. Testing at the partnership level with excess carried at partner level
D. Testing entirely at the partner level using the partner's own income

79. Which item does a taxpayer include in the excess business loss computation?

A. Aggregate deductions from all trades or businesses over aggregate income
B. Only losses from the taxpayer's principal business activity
C. Passive losses suspended under the passive activity rules
D. Capital losses in excess of capital gains for the taxable year

80. Which condition permits an S corporation to revoke its election voluntarily?

A. Approval by the corporation's board of directors alone
B. Consent of every shareholder holding stock on the effective date
C. Consent of shareholders holding more than half the shares
D. Filing of an amended return for the year of the revocation

81. Which item must a taxpayer establish to deduct a business travel meal?

A. That the taxpayer or an employee was present at the meal

B. That the meal cost less than a published per diem amount
C. That the meal was consumed at the taxpayer's own premises
D. That a written contract required the meal to be provided

82. Which item does a business deduct for a vehicle under the standard mileage rate?

A. Business miles multiplied by the published rate, plus parking and tolls
B. Actual fuel and maintenance costs in addition to the mileage
C. Depreciation computed separately from the mileage claimed
D. Lease payments in addition to the standard rate claimed

83. Which item does an employer report where it provides a vehicle for personal use?

A. Nothing, because vehicle provision is a working condition benefit
B. Only the fuel consumed during the employee's personal trips
C. The personal use value under an approved valuation method
D. The vehicle's full annual lease value regardless of business use

84. Which condition permits an employer to use the commuting valuation rule?

A. The employee must reimburse the employer for the commuting value
B. A written policy must prohibit personal use other than commuting
C. The vehicle must be used exclusively for commuting to and from work
D. The employee must be a highly compensated individual of the employer

85. Which item is included in the definition of a control employee for these rules?

A. An employee whose compensation exceeds a stated indexed amount
B. Any employee who has worked for the employer over ten years
C. Any employee whose duties involve operating company vehicles
D. An employee who participates in the employer's retirement plan

86. Which item does a cash method business deduct in the year of payment by credit card?

A. Nothing until the credit card balance is actually settled
B. The expense in the year the card charge is made
C. Half the expense in each of two consecutive years
D. The expense only where the card is in the business's name

87. Which condition applies where a cash method taxpayer pays by check?

A. The deduction arises when the check is delivered or mailed
B. The deduction arises only when the payee deposits the check
C. The deduction arises when the check clears the payer's bank
D. The deduction arises only where the check is certified in advance

88. Which item does the twelve-month rule permit a taxpayer to deduct currently?

A. Any prepaid amount regardless of the benefit period involved
B. Any prepayment where the taxpayer uses the accrual method only
C. A prepaid benefit not extending beyond twelve months or the next year end
D. Any prepayment covering services for the following three years

89. Which item must a business capitalize as a created intangible?

A. Amounts paid for routine advertising during the taxable year
B. Amounts paid to renew a licence or governmental permit held
C. Salaries of employees performing ordinary operating duties
D. Amounts paid for supplies consumed within the current year

90. Which item is excluded from the definition of a start-up expenditure?

A. Costs of investigating the creation of an active trade or business
B. Interest, taxes, and research costs otherwise deductible anyway
C. Costs of training employees before the business opens its doors
D. Advertising costs incurred before the business begins operating

91. Which item does a taxpayer capitalize where a business is investigated but not acquired?

A. The costs where the taxpayer was not already in that same business
B. The costs only where the target was a corporation rather than assets
C. Nothing, because unsuccessful investigation costs are always deductible
D. The costs only where negotiations reached a signed agreement

92. Which item is a partnership required to state separately for the qualified business income deduction?

A. Each partner's share of gross receipts for the taxable year
B. The partnership's aggregate depreciation for the taxable year
C. Qualified business income, W-2 wages, and unadjusted basis of property
D. Each partner's proportionate share of the entity's total assets

93. Which item does a taxpayer include in W-2 wages for the deduction limitation?

A. Guaranteed payments made to partners for services rendered
B. Payments to independent contractors performing similar services
C. Wages properly allocable to the qualified trade or business and timely reported
D. Wages reported by any business the taxpayer holds an interest in

94. Which item may a taxpayer not aggregate under the qualified business income rules?

A. A specified service trade or business with any other business

B. Two businesses under majority common ownership sharing facilities
C. Two businesses providing products customarily offered together
D. Two businesses operating in coordination with one another

95. Which item must a taxpayer disclose to maintain an aggregation across years?

A. An annual statement identifying each aggregated trade or business
B. A private letter ruling confirming the aggregation is permitted
C. Written consent from every owner of the aggregated businesses
D. A separate election filed in the first year and never repeated

96. Which item does an S corporation shareholder use to compute the deduction?

A. Amounts reported on the shareholder's own Schedule K-1
B. The corporation's taxable income before any deductions
C. The corporation's total gross receipts for the taxable year
D. The shareholder's percentage of outstanding shares held

97. Which entity computes the qualified business income deduction at the entity level?

A. A partnership computing it before allocating to its partners
B. An S corporation computing it before allocating to shareholders
C. No passthrough entity, since owners compute it on their own returns
D. A single-member limited liability company treated as disregarded

98. Which item does a trust or estate allocate between itself and beneficiaries for the deduction?

A. The capital gains allocated to corpus during the year
B. The exemption amount available to the entity for the year
C. Qualified business income and the related wage and property figures
D. The trustee fee paid during the taxable year in question

99. Which item does the anti-abuse rule for multiple trusts address?

A. Trusts with substantially the same grantor and primary beneficiaries
B. Trusts formed in different states to obtain varied treatment
C. Trusts holding interests in more than one operating business
D. Trusts established in different taxable years by one settlor

100. Which item does a taxpayer consider in determining a qualified trade or business?

A. Whether the activity generated a profit in the current year
B. Whether the activity employs at least one full-time worker
C. Whether the activity rises to the level of a trade or business
D. Whether the activity holds title to depreciable real property

Practice Exam 25: Answer Key and Explanations

1. B — The gross federal rate is six percent on the first seven thousand dollars of each employee's wages. A credit of up to five and four tenths percent is available for timely state contributions, leaving a net six tenths of one percent, or forty-two dollars per employee. Credit reduction states lose part of that credit.

2. D — Once qualified business use falls to fifty percent or below, the taxpayer must use straight line under the alternative depreciation system for that year and all later years. Depreciation claimed above what the alternative system would have allowed is recaptured as ordinary income in the year of the drop. Straight line applies for that year and all later years.

3. A — Section 736 divides liquidating payments into those for the partner's interest in partnership property, which are not deductible, and all other payments, which are treated as a distributive share or guaranteed payment and reduce the remaining partners' income. Characterization therefore matters greatly to both sides. Characterization therefore matters greatly to both sides.

4. C — The mixing bowl rule requires the contributing partner to recognize remaining precontribution gain where the property is distributed to another partner within seven years. A companion rule reaches the reverse pattern, where the contributor receives other property. Both prevent using the partnership to swap appreciated assets tax free. A companion rule reaches the reverse distribution pattern.

5. B — A pro rata stock dividend is generally not taxable and simply reallocates basis across the larger number of shares. It becomes taxable where any shareholder may elect cash or other property instead, where the distribution is disproportionate, or where preferred is distributed on common in defined circumstances. Preferred distributed on common may also become taxable.

6. C — Corporate installments fall on the fifteenth day of the fourth, sixth, ninth, and twelfth months of the taxable year, which for a calendar-year corporation means April, June, September, and December. The individual pattern differs, running to January of the following year for the final payment. The individual pattern differs and runs into January.

7. A — The five and five power permits an annual withdrawal right over the greater of five thousand dollars or five percent of corpus to lapse without the holder being treated as having made a release. Powers to revoke, to control enjoyment, or to borrow without security all trigger grantor trust treatment.

8. D — A safe harbor design avoids the actual deferral and contribution percentage tests entirely by making either a three percent nonelective contribution or a prescribed match, fully vested immediately, with timely notice to participants. Ordinary plans must test annually and correct failures through refunds or additional contributions. Timely notice to participants is also required each year.

9. C — The residual method allocates price to seven classes in order, with goodwill and going concern value taking whatever remains after every other class is satisfied at fair market value. Buyers therefore prefer allocating to shorter-lived assets, while sellers prefer goodwill producing capital gain. Sellers prefer goodwill because it produces capital gain.

10. D — The exclusion is unavailable to C corporations. It reaches debt incurred or assumed in connection with real property used in a trade or business and secured by that property. The excluded amount is capped by the excess of debt over value and by the aggregate basis of depreciable real property held.

11. A — This exclusion reduces the basis of depreciable real property rather than following the general attribute reduction order. That targeted reduction is why the exclusion is often more attractive than it first appears: the cost is deferred through smaller future depreciation rather than lost immediately. The cost is deferred through smaller future depreciation.

12. B — The smallest employers file annually rather than quarterly, but only where the Service notifies them that they qualify. An employer cannot simply choose the annual form, and one that has been notified must file annually rather than reverting to quarterly filing without permission to change. An employer cannot simply choose the annual form itself.

13. B — Employees report tips of twenty dollars or more monthly, and the employer withholds income and payroll taxes on the reported amounts from other wages. A large food or beverage establishment must additionally allocate tips among employees where reported tips fall below eight percent of gross receipts. The eight percent allocation rule applies to large establishments.

14. D — The employer receives a credit for its share of Social Security and Medicare tax on tips above the amount treated as wages for minimum wage purposes. It forms part of the general business credit, and no deduction is allowed for the same taxes to the extent the credit is claimed.

15. A — The alternative system is mandatory for property used predominantly outside the country, tax-exempt use property, tax-exempt bond financed property, listed property failing the business use test, and certain farming and real property businesses electing out of the interest limitation. It may also be elected voluntarily. It may also be elected voluntarily on a class basis.

16. C — Roofs, heating, ventilation and air conditioning, fire protection and alarm systems, and security systems installed on nonresidential real property after it was first placed in service qualify. Enlargements, elevators and escalators, and internal structural framework are expressly excluded from qualified improvement property. Enlargements and structural framework are expressly excluded. Only post-placement work on existing buildings qualifies.

17. B — A lessee deducts the business portion of lease payments but must reduce the deduction by an inclusion amount drawn from a published table, which approximates the depreciation caps a purchaser would face. The mechanism prevents leasing from becoming a route around the passenger automobile limits. The mechanism prevents leasing circumventing the caps.

18. D — Pledging an installment obligation from certain sales is treated as a receipt of payment to the extent of the loan proceeds, accelerating gain. Disposing of the obligation likewise triggers recognition. Death does not accelerate it; the obligation passes as income in respect of a decedent instead. Death passes the obligation as income in respect of a decedent.

19. A — Where a deferred payment contract states no interest or an inadequate rate, interest is imputed at the applicable federal rate. The imputed portion is ordinary interest income to the seller rather than part of the sale price, which reduces the gain and changes its character materially. The imputed portion changes the character of the income.

20. B — Earnings and profits use the alternative depreciation system, so accelerated depreciation claimed above that amount is added back. Section 179 expense is likewise spread across five years rather than deducted at once, since earnings and profits measure genuine economic capacity to distribute. Section 179 expense is spread across five years instead.

21. C — Section 306 stock is preferred received in a nontaxable distribution that would have been a dividend had cash been paid. Selling it produces ordinary income to the extent of the earnings and profits at issue, which prevents converting dividend income into capital gain through a preferred bailout. It prevents converting dividends into capital gain by bailout.

22. D — A consent dividend is an amount shareholders agree in writing to treat as distributed and immediately recontributed as capital, though no cash moves. It counts toward the dividends paid deduction, which matters where a corporation seeks to avoid the personal holding company or accumulated earnings tax. It counts toward the dividends paid deduction claimed.

23. C — The annualized income installment method bases each payment on income actually earned through that point in the year, annualized. It helps a corporation whose income arrives late in the year. A separate adjusted seasonal installment method serves corporations with genuinely seasonal patterns of earning. A seasonal method serves genuinely seasonal businesses.

24. A — An electing small business trust may have multiple beneficiaries and accumulate income, with the S portion taxed at the trust level at the highest rate. A qualified subchapter S trust by contrast must have a single income beneficiary who elects and is then taxed on the S income directly. The S portion is taxed at the highest applicable rate.

25. D — A qualified subchapter S trust must have exactly one current income beneficiary who is a citizen or resident, must distribute all income currently, and any corpus distributed must go to that beneficiary. The beneficiary makes the election and is treated as owner of the S corporation stock. The beneficiary is treated as owner of the S corporation stock.

26. A — A supporting organization avoids private foundation status by being organized and operated exclusively to benefit specified public charities, with one of three permitted relationships. The third type faces additional payout and responsiveness requirements because the supported charity exercises the least control over it. The third type faces additional payout and responsiveness rules.

27. B — A qualified sponsorship payment carries no substantial return benefit beyond acknowledgment, which may include the sponsor's name, logo, and product lines. It becomes taxable advertising where messages include qualitative comparisons, price information, or endorsements, and where payment is contingent on attendance or exposure. Contingent payments fall outside the safe harbor entirely.

28. C — Bingo is excluded where it is legal in the jurisdiction and commercial bingo is not permitted there. Other gaming escapes tax only through the volunteer labour exception or by being irregular. Regularly conducted gaming staffed by paid workers produces unrelated business taxable income for the organization. Volunteer labour or irregularity are the other escapes.

29. C — Required minimum distributions begin by the required beginning date, and a more than five percent owner cannot defer past that date by continuing to work, unlike an ordinary employee. Failure to take the required amount carries an excise tax on the shortfall, reduced where corrected promptly. An excise tax applies to any shortfall not taken timely.

30. A — A direct trustee-to-trustee transfer avoids the twenty percent mandatory withholding entirely. An indirect rollover suffers the withholding, and the participant must replace that amount from other funds within sixty days to roll the full balance, or the withheld portion becomes a taxable distribution. The withheld portion otherwise becomes a taxable distribution.

31. B — An employer may exclude an employee who has not performed service in at least three of the immediately preceding five years, who has not reached age twenty-one, or whose compensation falls below a stated floor. Coverage by another plan and years of continuous service are irrelevant here. Age twenty-one and a compensation floor also permit exclusion.

32. D — Conservation reserve program payments are excluded from self-employment income for taxpayers receiving social security retirement or disability benefits. Custom work, materially participating crop share arrangements, and cooperative patronage dividends all remain within self-employment earnings for the farmer receiving them. Custom work and material participation remain within earnings. The exclusion turns on the taxpayer receiving those benefits.

33. D — Farm income averaging is computed on its own schedule, applying elected farm income against the three base years' unused bracket capacity. The elected amount need not be the entire farm income, and choosing the amount to elect is itself a planning decision made after the year's results are known. The elected amount need not be the entire farm income.

34. A — A taxpayer may group activities constituting an appropriate economic unit, which can convert a losing activity into part of one where the taxpayer materially participates. Groupings must be disclosed and are generally binding in later years, so the decision requires care at the outset. Groupings must be disclosed and generally bind later years.

35. B — Where a taxpayer lends to a passthrough entity in which they hold a passive interest, the interest income received would ordinarily be portfolio income while the entity's deduction is passive. The self-charged rules recharacterize a matching portion as passive so the two can offset each other. The recharacterization allows the two amounts to offset.

36. C — Where a taxpayer begins materially participating in a previously passive activity, prior suspended losses may be deducted against income from that same activity. Any remainder stays suspended and continues under the ordinary passive rules until the activity is disposed of in a fully taxable transaction. Any remainder stays suspended under the ordinary rules.

37. B — Where withdrawals or liability shifts drive the at-risk amount below zero, previously allowed losses are recaptured as income to that extent. The recaptured amount is then treated as a deduction allocable to the activity in later years, so the effect is a reversal of timing rather than a permanent cost.

38. A — Qualified nonrecourse financing must be borrowed for holding real property, secured by that property, from a qualified person or government, with no personal liability. Seller financing and loans from persons with an interest in the activity are excluded, as is any financing on activities other than real property. Seller financing and interested-person loans are excluded.

39. C — Class III consists of accounts receivable, mortgages, and credit card receivables. Cash falls in Class I, actively traded securities in Class II, inventory in Class IV, other tangible property in Class V, most Section 197 intangibles in Class VI, and goodwill in Class VII. Cash falls in Class I and inventory in Class IV instead.

40. D — A domestic partnership with a financial interest in or signature authority over foreign accounts exceeding the aggregate threshold at any point during the year must file the foreign bank account report. Separate information return obligations may also arise for interests in foreign corporations and partnerships. Separate information returns may also become due.

41. B — Partial worthlessness is available only for business bad debts, and only to the extent the amount is charged off on the books during the year. A nonbusiness bad debt requires complete worthlessness and produces a short-term capital loss whatever the debt's actual holding period. Nonbusiness debts require complete worthlessness instead.

42. C — Carryforwards from earlier years are used first, then the current year's credits, then carrybacks. This ordering protects the oldest credits, which face expiry after twenty years, from being stranded behind newer amounts that still have most of their carryforward period remaining to run. This protects the oldest credits from expiring unused.

43. D — The credit covers qualified childcare facility expenditures including acquisition, construction, and operation, together with resource and referral expenditures, at separate rates subject to an annual dollar cap. Recapture applies where the facility ceases to operate as such within ten years of being placed in service. Recapture applies if the facility closes within ten years.

44. A — The employer must have a written policy providing qualifying employees at least two weeks of annual paid family and medical leave at not less than half normal wages. The credit percentage rises with the rate of payment, and no deduction is allowed for wages to the extent credited. The credit percentage rises with the rate of payment made.

45. C — A taxpayer may estimate inventory shrinkage for periods between physical counts where physical counts are taken at each location at least annually and the estimating method is applied consistently and adjusted to actual results. The estimate must be based on genuine experience rather than a convenient assumption. The estimate must rest on genuine experience each year.

46. B — Dollar-value last-in, first-out groups similar items into pools measured in base year dollars, using an index to convert current cost back to base year cost. It reduces the record keeping burden considerably and avoids liquidating layers when the mix of items within a pool shifts. It avoids liquidating layers when the item mix shifts.

47. A — The retail method computes ending inventory by applying a cost complement to retail selling prices, so records of retail prices and markups are essential. It is a permitted method for resellers and may be combined with either cost or lower of cost or market valuation as elected. It may be combined with cost or lower of cost or market.

48. D — Farmers meeting the applicable conditions may elect out of the uniform capitalization rules for plants with a preproductive period exceeding two years, deducting those costs instead. Electing out requires using the alternative depreciation system for all farming assets, which is a substantial trade-off. Electing out requires the alternative system for farm assets.

49. A — A Section 754 election triggers a Section 734 adjustment to the basis of remaining partnership property where a distribution causes a disparity, and a Section 743 adjustment on a transfer of an interest. The former benefits all partners; the latter belongs to the transferee alone. The former benefits all partners rather than just one.

50. B — Where the partnership has a substantial built-in loss immediately after a transfer, the basis adjustment is mandatory whether or not an election is in place. A parallel mandatory rule applies to distributions producing a substantial basis reduction, closing what was formerly an elective loss duplication. A parallel rule reaches substantial basis reductions.

51. D — A publicly traded partnership is treated as a corporation unless at least ninety percent of its gross income is qualifying passive-type income such as interest, dividends, rents, and natural resource income. Its passive losses are also suspended and usable only against income from that same partnership. Interest, dividends, rents, and resource income all qualify.

52. C — A more-than-two-percent shareholder is treated like a partner and cannot exclude most fringe benefits, including health insurance, group term life, and meals and lodging. Qualified retirement plan contributions remain fully available, which is why plan design matters so much for these shareholders. Plan design therefore matters greatly for such shareholders.

53. B — A redemption failing the exchange treatment tests is an ordinary distribution, running through the accumulated adjustments account and the other distribution tiers rather than producing capital gain. The attribution rules apply here exactly as they do for a C corporation redemption of shares. The attribution rules apply exactly as for a C corporation.

54. C — The throwback rules now apply only to foreign trusts and to certain domestic trusts previously treated as foreign. They tax a beneficiary receiving an accumulation distribution as though the income had been distributed when earned, adding an interest charge for the period of deferral. An interest charge accompanies the accumulation distribution.

55. A — Where an estate or trust has substantially separate and independent shares for different beneficiaries, distributable net income is computed separately for each share. The rule prevents a distribution to one beneficiary from carrying out income economically belonging to another beneficiary's share entirely. Each share computes its own distributable net income figure.

56. D — The fiduciary may elect to treat an in-kind distribution as a sale at fair market value, recognizing gain or loss at the entity level and giving the beneficiary a fair market value basis. Absent the election the beneficiary generally takes a carryover basis with no gain recognized. Absent the election a carryover basis passes to the beneficiary.

57. B — Miscellaneous itemized deductions subject to the two percent floor are suspended, so nothing sits in that category currently. Costs unique to trust administration were always outside the floor and remain fully deductible, while ordinary investment advisory fees are now disallowed entirely rather than merely floored. Investment advisory fees are now disallowed entirely instead.

58. A — The foundation and its disqualified persons together may generally hold no more than twenty percent of a business enterprise, raised to thirty-five percent where unrelated persons have effective control. Holdings received by gift or bequest carry a disposal period before the tax begins to apply. Gift and bequest holdings carry a disposal period first.

59. D — A jeopardizing investment is one where managers failed to exercise ordinary business care and prudence in providing for the foundation's needs. No category of investment is per se jeopardizing, though certain types attract scrutiny. Programme-related investments are expressly excluded from the rule entirely. Programme-related investments are expressly excluded from it.

60. C — The annual return requires disclosure of compensation for officers, directors, trustees, key employees, and the highest compensated employees above a threshold, together with independent contractors. Because the return is publicly inspectable, this disclosure is one of the most scrutinized parts of the filing. Public inspection makes this among the most scrutinized parts.

61. D — Intermediate sanctions impose an excise tax on the disqualified person receiving the excess benefit, with a further tax where it is not corrected, and a separate tax on organization managers who knowingly approved it. A rebuttable presumption of reasonableness is available through a defined approval process. A further tax applies where the excess is not corrected.

62. B — The presumption arises where an authorized body without conflicts of interest approves the arrangement in advance, relies on appropriate comparability data, and adequately documents the basis for its determination. Meeting all three shifts the burden to the Service to demonstrate unreasonableness. Meeting all three shifts the burden onto the Service itself.

63. C — Transit passes, vanpool benefits, and qualified parking remain excludable to the employee within monthly limits, though the employer's deduction for providing them was eliminated. Cash allowances and ordinary commuting reimbursements are taxable wages, and bicycle commuting reimbursement is currently suspended. Bicycle commuting reimbursement is currently suspended entirely. The employer deduction for providing them was eliminated.

64. A — A qualified educational assistance programme must be written, must not discriminate in favour of highly compensated employees, and must not offer a choice between assistance and taxable compensation. Assistance within the annual limit is excludable, and no more than five percent may go to more-than-five-percent owners. No more than five percent may go to substantial owners.

65. C — A below-market compensation-related loan produces imputed interest treated as additional wages to the employee, deductible by the employer, with the employee treated as paying it back as interest. A de minimis exception applies to aggregate loans below a stated threshold where tax avoidance is not a principal purpose. A de minimis exception covers small aggregate balances.

66. B — A de minimis fringe is so small that accounting for it is unreasonable or administratively impracticable, covering occasional personal use of office equipment, occasional snacks, and holiday gifts of nominal value. Cash and cash equivalents including gift certificates never qualify whatever their amount. Cash and cash equivalents never qualify whatever the amount.

67. A — The special accounting rule permits treating benefits provided during the last two months of the year as paid during the following year, easing the year-end valuation burden. The rule must be applied consistently to all employees for the benefits covered and the employees must be notified. Employees must be notified that the rule is being used.

68. D — Both buyer and seller file an asset acquisition statement reporting the allocation of consideration across the asset classes, and the allocations must be consistent. An amended statement is required where the consideration later changes, such as through a contingent earnout payment being made. An amended statement follows any later change in price.

69. D — Income accrues when all events have occurred fixing the right to receive it and the amount can be determined with reasonable accuracy, ordinarily the earliest of performance, payment due, or payment received. A separate rule now requires conformity with revenue recognized in an applicable financial statement. Financial statement conformity now governs many taxpayers.

70. A — Rebates and refunds are payment liabilities for which economic performance occurs on payment. The recurring item exception permits accruing them in the earlier year where payment occurs within eight and a half months, the item recurs and is treated consistently, and matching or materiality is satisfied. Matching or materiality must also be satisfied to qualify.

71. B — Workers compensation, tort, breach of contract, and violation of law liabilities all have economic performance only when payment is made, so accruing an estimated reserve produces no deduction. Services and property liabilities instead have performance as the services or property are actually provided. Estimated reserves therefore produce no deduction at all.

72. C — Amounts facilitating an acquisition must be capitalized, with a bright line date separating investigatory costs that may be deducted from facilitative costs that may not. Employee compensation and overhead are treated as non-facilitative by default, which spares taxpayers a difficult allocation exercise. Employee compensation is non-facilitative by default. Overhead is likewise treated as non-facilitative by default.

73. C — Wages of a nonresident alien employee are subject to graduated withholding computed using special procedures that add an adjustment amount, reflecting that such employees generally cannot claim the standard deduction. Treaty provisions may reduce or eliminate withholding where a valid certification is filed. Treaty provisions may reduce or eliminate the withholding.

74. D — Withholding applies to effectively connected taxable income allocable to foreign partners whether or not any distribution is made, remitted through quarterly instalments. A separate withholding regime reaches the disposition of a partnership interest by a foreign partner where the partnership conducts a trade or business. A separate regime reaches dispositions of the interest itself.

75. A — A United States person meeting the ownership thresholds in a foreign corporation must file an information return reporting the corporation's income, balance sheet, and transactions with related parties. Penalties for non-filing are substantial and the limitations period stays open until the return is filed. The limitations period stays open until the return is filed.

76. B — Adjusted taxable income starts with taxable income and adds back business interest expense, business interest income, net operating losses, and the qualified business income deduction. Depreciation and amortization are no longer added back, which materially tightened the limitation for capital-intensive businesses. Depreciation is no longer added back to that figure.

77. B — A real property trade or business may elect out of the interest limitation, but the election is irrevocable and requires using the alternative depreciation system for residential rental, nonresidential real, and qualified improvement property. Longer recovery periods are the price paid for full interest deductibility. Longer recovery periods are the price of full deductibility.

78. D — The limitation applies at the partnership level, and disallowed amounts are allocated to partners as excess business interest expense carried forward at partner level. It becomes deductible only as that partnership allocates excess taxable income in later years, which can strand deductions for a long time. Excess taxable income allocations release it in later years.

79. A — The computation aggregates deductions from all trades or businesses against aggregate business income and gains, testing the net figure against the annual threshold. Wages are not business income for this purpose, and capital losses enter only within defined limits before the threshold is applied. Wages are not treated as business income for this purpose.

80. C — Revocation requires the consent of shareholders holding more than half the issued shares, counting nonvoting shares. Filed by the fifteenth day of the third month it is effective from the year's start; filed later it takes effect the following year, or on a stated prospective date. Nonvoting shares count toward the consent requirement.

81. A — The meal must not be lavish or extravagant, the taxpayer or an employee must be present, and it must be provided to a business contact. Fifty percent is deductible, and substantiation of amount, time, place, business purpose, and relationship is required in every case. Substantiation of purpose and relationship is always required.

82. B — The standard rate covers fuel, maintenance, insurance, and depreciation, with only business parking and tolls deductible on top. The rate must generally be chosen in the first year the vehicle is used for business, and depreciation deemed included reduces basis for later disposition. Deemed depreciation reduces basis for a later disposition.

83. D — The employer values personal use under the general valuation rule, the annual lease value rule, the cents-per-mile rule, or the commuting rule, and includes that value in wages. The employee's business use is a working condition fringe, but only the business portion qualifies for that exclusion. Only the business portion qualifies as a working condition fringe.

84. C — The commuting rule requires a written policy prohibiting personal use other than commuting, actual compliance with that policy, a bona fide non-compensatory business reason for providing the vehicle, and that the employee not be a control employee. All conditions must hold simultaneously. All of the stated conditions must hold simultaneously.

85. C — A control employee is a board or shareholder appointed officer above a compensation threshold, a director, a one percent owner, or an employee whose compensation exceeds a stated indexed figure. Control employees cannot use the commuting valuation rule and face other restrictions. Control employees also face other valuation restrictions. A one percent owner is a control employee regardless of pay.

86. A — Payment by credit card is treated as payment at the time of the charge, because the taxpayer has borrowed from a third party to pay the vendor. Later repayment of the card balance is repayment of a loan and produces no further deduction whatever. Repaying the card balance is repayment of a loan instead.

87. B — Delivery or mailing of a check produces the deduction provided the check is honoured in due course and funds were available. Postdating defers it. The rule mirrors constructive receipt on the income side, where a check available on the last day is income that day. Postdating the check defers the deduction accordingly.

88. D — The twelve-month rule permits deducting a prepaid expense where the benefit does not extend beyond the earlier of twelve months or the end of the following taxable year. A three-year prepayment fails and must be capitalized and amortized across the period benefited instead. Longer prepayments must be capitalized and amortized.

89. B — Amounts paid to obtain, renew, or upgrade a right granted by a government agency must be capitalized as a created intangible, along with amounts creating certain financial interests and defending title. Routine advertising, ordinary salaries, and consumable supplies remain currently deductible period costs. Defending title also creates a capitalized intangible.

90. A — Interest, taxes, and research and experimental expenditures are excluded because they are deductible under their own provisions regardless of when the business begins. Genuine start-up costs include investigation, pre-opening training, advertising, and salaries paid before active operations commence. Genuine start-up costs include investigation and pre-opening training. Those costs are deductible under their own provisions anyway.

91. C — A taxpayer already in the same trade or business deducts investigation costs whether or not the acquisition proceeds. A taxpayer not yet in that business capitalizes them as start-up costs if the business is acquired, and may claim an abandonment loss if the search is definitively abandoned. Definitive abandonment may instead produce a loss deduction.

92. D — The partnership must report each partner's share of qualified business income, W-2 wages, and the unadjusted basis immediately after acquisition of qualified property, plus whether any trade or business is a specified service business. Without these the partner cannot compute the deduction. Specified service status must also be reported to owners.

93. D — W-2 wages must be properly allocable to the qualified trade or business and must have been reported on returns filed with the Social Security Administration within sixty days of the due date. Guaranteed payments and contractor payments are not wages and never count toward the limitation. Timely filing with the Social Security Administration is required.

94. B — A specified service trade or business may never be aggregated with any other business, which prevents wages and property of a qualifying business from supporting a service business's deduction. The other options describe conditions that support aggregation rather than preventing it entirely. The other options describe conditions supporting aggregation. Common ownership and coordinated operation both support it.

95. A — The taxpayer must attach an annual statement identifying each aggregated trade or business and describing how the requirements are met. Aggregation is generally binding in later years, though a new business may be added and a changed factual position must be disclosed and explained. A changed factual position must be disclosed and explained.

96. C — The shareholder computes the deduction from the qualified business income, W-2 wages, and unadjusted basis figures reported on the Schedule K-1. Reasonable compensation paid to the shareholder is excluded from qualified business income but does count toward the W-2 wage limitation figure. Reasonable compensation still counts toward the wage limit.

97. A — Passthrough entities never compute the deduction themselves; they report the components and each owner computes it on their own return applying their own taxable income, thresholds, and any aggregation. A trust or estate is the exception, computing it at entity level for retained income. Trusts and estates are the exception to that general rule.

98. D — A trust or estate allocates qualified business income, W-2 wages, and unadjusted basis of property between itself and its beneficiaries in proportion to distributable net income distributed. Retained amounts support the entity's own deduction, tested against the entity's own threshold amounts. Retained amounts support the entity's own deduction figure. Distributable net income distributed drives the allocation.

99. B — Where multiple trusts have substantially the same grantor and primary beneficiaries and a principal purpose is avoiding income tax, they are aggregated and treated as a single trust. The rule prevents dividing income across trusts to multiply threshold amounts and lower bracket capacity. It prevents multiplying thresholds across several trusts.

100. C — The activity must rise to the level of a trade or business under the ordinary standard, requiring regularity, continuity, and a profit motive. Profitability in any single year, employment of workers, and property ownership are all irrelevant to whether that threshold standard is met. Regularity, continuity, and profit motive are all required.