PRACTICE EXAM 29: 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. Kofi begins with 96,000 dollars of basis, contributes 15,000, is allocated 22,000 of income and an 11,000 liability increase, receives a 38,000 distribution and a 6,000 liability decrease, and is allocated a 124,000 loss. How much loss is suspended?

A. One hundred thousand dollars, the amount actually deductible
B. Twenty-four thousand dollars, with basis reduced to zero
C. No loss is suspended, because ample basis remains throughout
D. Twenty-eight thousand dollars, using a different ordering

2. Amara sells equipment for 48,000 dollars that cost 95,000 and on which she claimed 62,000 of depreciation. How is the gain characterized?

A. Fifteen thousand dollars entirely as ordinary recapture income
B. Fifteen thousand dollars entirely as Section 1231 gain
C. Sixty-two thousand ordinary and no Section 1231 component
D. Forty-eight thousand ordinary with a fifteen thousand loss

3. A taxpayer has 85,000 of Section 1231 gains, 30,000 of Section 1231 losses, and 20,000 of nonrecaptured losses from the prior five years. How is the net gain characterized?

A. Twenty thousand ordinary and thirty-five thousand capital
B. Fifty-five thousand dollars entirely as long-term capital gain
C. Fifty-five thousand dollars entirely as ordinary income
D. Thirty thousand ordinary and twenty-five thousand capital

4. A corporation with 300,000 of taxable income before the deduction contributes 40,000 and holds a 15,000 carryforward. What is deducted and what carries forward?

A. Thirty thousand from the carryforward first, then ten thousand current
B. Fifty-five thousand deducted in full with nothing carried forward
C. Thirty thousand deducted with twenty-five thousand carried forward
D. Forty thousand deducted with fifteen thousand carried forward

5. An S corporation with 35,000 in its adjustments account and 40,000 of accumulated earnings distributes 120,000 to a shareholder whose stock basis is 70,000. What capital gain arises?

A. Eighty-five thousand dollars, the excess over the adjustments account
B. Ten thousand dollars once all four tiers are worked through
C. Forty-five thousand dollars after the first two tiers
D. No capital gain, because stock basis covers the distribution

6. A proprietor with 50,000 of business gross income and 41,000 of other business expenses uses 300 of 1,500 square feet as an office. Allocable costs are interest 10,000, taxes 2,500, insurance 1,500, utilities 3,500, and depreciation 4,000. What is the deduction?

A. Nine thousand dollars, equal to the full income limitation
B. Four thousand four hundred dollars using the simplified method
C. Four thousand three hundred dollars across the three tiers
D. Four thousand one hundred dollars after the ordering rules

7. Which item does the taxpayer in the preceding question carry forward?

A. Nothing, because all allocated expenses were fully deducted
B. The unused portion of the income limitation for the year
C. The disallowed depreciation of eight hundred dollars
D. The personal portion of the interest and taxes allocated

8. Which figure does a taxpayer use where the simplified home office method applies to 350 square feet?

A. Three hundred square feet, being the maximum permitted area
B. Three hundred fifty square feet at the published rate
C. The actual expenses, since the area exceeds the simplified cap
D. Half the area, because the space exceeds the stated threshold

9. Which item does a taxpayer lose by using the simplified home office method?

A. The ability to claim any home office deduction in later years
B. The depreciation deduction and any carryforward of excess
C. The deduction for mortgage interest and property taxes entirely
D. The ability to treat the home as a principal place of business

10. A cash-basis consultant bills 30,000 in December and collects it in February. A client pays a 12,000 retainer in November for work performed the following March. What is reported for the earlier year?

A. Twelve thousand dollars, being the retainer actually received
B. Forty-two thousand dollars, both amounts having been earned
C. Thirty thousand dollars, being the amount billed in December
D. Nothing, since neither amount was both billed and collected

11. How would the preceding facts differ for an accrual-basis consultant?

A. Only the December billing would be reported in the earlier year

B. Neither amount would be reported until cash was received
C. Both amounts would be reported in the earlier year received or earned
D. Both amounts would be deferred to the year services are performed

12. A business places 90,000 of equipment in service in March and 140,000 in November, with no real property. Which convention applies?

A. The mid-quarter convention, as the fourth quarter share is sixty percent
B. The half-year convention, since the total is under the threshold
C. The mid-month convention applied to both placements alike
D. A blended convention weighting each placement by its cost

13. Which consequence does the mid-quarter convention produce for the March placement?

A. Treated as placed in service at the midpoint of the first quarter
B. Treated as placed in service at the midpoint of the taxable year
C. Treated as placed in service on the actual date in March
D. Excluded from depreciation entirely for the first taxable year

14. A shareholder transfers property with a 70,000 basis and 110,000 value for stock plus a 25,000 note. What gain is recognized and what is the stock basis?

A. Twenty-five thousand gain recognized with a basis of seventy thousand
B. Forty thousand gain recognized with a basis of one hundred ten thousand
C. No gain recognized with a basis of forty-five thousand
D. Twenty-five thousand gain recognized with a basis of ninety-five thousand

15. What basis does the corporation take in that property?

A. Seventy thousand dollars, the transferor's carryover basis
B. Forty-five thousand dollars, net of the note issued

C. Ninety-five thousand dollars, basis plus the gain recognized
D. One hundred ten thousand dollars, its fair market value

16. A partner contributes land with a 40,000 basis and 100,000 value, and the partnership sells it three years later for 130,000. How is the gain allocated?

A. Thirty thousand to the contributor and sixty thousand shared
B. Sixty thousand to the contributor and thirty thousand shared
C. Ninety thousand shared equally among all of the partners
D. Ninety thousand entirely to the contributing partner alone

17. A partnership distributes land with a 45,000 inside basis to a partner whose outside basis is 30,000. What basis does the partner take?

A. Thirty-seven thousand five hundred dollars, an average of the two
B. Zero, with the entire distribution producing immediate gain
C. Thirty thousand dollars, limited to the outside basis available
D. Forty-five thousand dollars, the partnership's carryover basis

18. A calendar-year corporation expects 400,000 of tax and had 320,000 last year. What is the minimum first installment to avoid penalty?

A. Eighty thousand dollars, a quarter of the prior year figure
B. One hundred thousand dollars, a quarter of the current estimate
C. Four hundred thousand dollars paid with the return itself
D. Three hundred twenty thousand spread across the four periods

19. How does the answer change if the corporation had 1,200,000 of tax last year?

A. The prior year safe harbor remains available for every installment
B. Only the first installment may use the prior year safe harbor

C. All four installments must use the prior year figure throughout
D. No safe harbor is available and penalties are unavoidable

20. A sole proprietor has 140,000 of net profit. Approximately what is the deductible half of self-employment tax?

A. Approximately nine thousand nine hundred dollars
B. Approximately ten thousand seven hundred dollars
C. Approximately twenty-one thousand four hundred dollars
D. Approximately seven thousand dollars on the net profit

21. Which item does that deduction affect for the qualified business income computation?

A. It reduces qualified business income for the deduction computation
B. It has no effect, being an adjustment rather than a business cost
C. It increases qualified business income by the amount deducted here
D. It affects only the taxable income cap rather than the income figure

22. A business acquires a going concern for 800,000, allocating 500,000 to tangible assets and 100,000 to a covenant not to compete. What is the goodwill?

A. Three hundred thousand dollars, the residual over tangible assets
B. Two hundred thousand dollars as the Class VII residual amount
C. One hundred thousand dollars allocated to Class VI intangibles
D. Eight hundred thousand dollars until an appraisal is obtained

23. Over what period does the buyer recover the covenant and the goodwill?

A. Both over the recovery period of the tangible assets acquired
B. The covenant immediately and goodwill over fifteen years
C. Both over fifteen years beginning with the acquisition month

D. The covenant over its stated term and goodwill over fifteen years

24. A shareholder-employee of an S corporation takes 30,000 of wages and 200,000 of distributions from a business generating 250,000. What risk arises?

A. Recharacterization of distributions as additional taxable wages
B. The distributions being recharacterized as a taxable dividend
C. Loss of the S election for failure to pay adequate compensation
D. Disallowance of the corporation's deduction for the wages paid

25. Which factor does not support the reasonableness of that compensation?

A. The compensation comparable businesses pay for similar roles
B. The hours the shareholder devotes to the business each week
C. The corporation's need to preserve cash for future expansion
D. The complexity of the duties the shareholder actually performs

26. A trust with 60,000 of distributable net income distributes 25,000 to a mandatory income beneficiary and 50,000 to a discretionary beneficiary. What does the second report?

A. Thirty-five thousand dollars, the remaining distributable income
B. Fifty thousand dollars, the full amount actually received
C. Twenty-five thousand dollars, matching the first beneficiary
D. Nothing, since first-tier distributions absorbed the income

27. An estate has 30,000 of gross income and 800 of taxable income. Must it file?

A. Yes, because gross income exceeds six hundred dollars
B. No, because taxable income falls below the exemption amount
C. Only where a beneficiary is a nonresident alien individual
D. Only where the estate distributes income during the year

28. An exempt organization has 4,000 of gross unrelated business income and 3,500 of directly connected expenses. What is reported?

A. Four thousand dollars, since expenses are not deductible
B. Five hundred dollars net, reduced to zero by the specific deduction
C. Nothing, since the net amount falls below the filing threshold
D. Three thousand five hundred dollars as the deductible portion

29. A farmer sells raised breeding cattle held thirty months for 45,000. What is reported?

A. Capital gain reduced by the accumulated costs of raising them
B. Nothing, because the costs of raising were already deducted
C. Section 1231 gain of forty-five thousand with a zero basis
D. Ordinary income of forty-five thousand from farming operations

30. How would the answer differ if the cattle had been purchased and depreciated?

A. Recapture applies to the depreciation with the balance Section 1231
B. The entire gain becomes ordinary income regardless of the period
C. The gain becomes capital gain without any recapture component
D. No gain arises because purchased animals retain their full basis

31. A partnership has 300,000 of ordinary income and pays a 60,000 guaranteed payment. What does a twenty-five percent partner report?

A. Sixty thousand plus sixty thousand, being payment and share
B. Seventy-five thousand dollars as the distributive share alone
C. Ninety thousand dollars, combining the payment and the share
D. One hundred thirty-five thousand dollars from both sources

32. Which item does that partner include in self-employment earnings as a general partner?

A. Only the distributive share of ordinary business income
B. Neither amount, since partners are not employees at all
C. Only the guaranteed payment received for services rendered
D. Both the guaranteed payment and the distributive share

33. A corporation distributes property worth 90,000 with a 55,000 basis to a shareholder. What does each party report?

A. Thirty-five thousand gain to the corporation and a fifty-five thousand distribution
B. No gain to the corporation and a fifty-five thousand distribution
C. Thirty-five thousand gain to the corporation and a ninety thousand distribution
D. No gain to the corporation and a ninety thousand distribution

34. How would the answer differ if the property had a 110,000 basis and 90,000 value?

A. No loss is recognized by the corporation on the distribution
B. A twenty thousand loss is recognized reducing earnings and profits
C. The shareholder takes a one hundred ten thousand carryover basis
D. The distribution is treated as a sale producing a deductible loss

35. A business has 900,000 of receipts, 400,000 of cost of goods sold, and 350,000 of other expenses. Which figure is tested against the gross receipts threshold?

A. One hundred fifty thousand dollars, the net profit for the year
B. Nine hundred thousand dollars, the receipts before any deduction
C. Five hundred thousand dollars, being the gross profit figure
D. Five hundred fifty thousand, receipts net of other expenses

36. A taxpayer materially participates in a business generating a 90,000 loss, with 40,000 of basis and 65,000 at risk. What is deductible?

A. Sixty-five thousand dollars, limited by the amount at risk
B. Ninety thousand dollars, since material participation was present
C. Forty thousand dollars, limited by the available basis
D. Twenty-five thousand dollars, being the difference between them

37. How would the answer change if the taxpayer did not materially participate?

A. The loss would be deductible only against portfolio income
B. The forty thousand would be suspended absent passive income
C. The entire loss would be disallowed regardless of basis available
D. The loss would convert into a capital loss for the year

38. A business pays 8,000 for a client's box at a sporting venue used for entertaining. What is deductible?

A. Nothing, because entertainment is entirely nondeductible
B. Four thousand dollars, being fifty percent of the amount paid
C. Eight thousand dollars, since a business purpose was present
D. Two thousand dollars, being twenty-five percent of the cost

39. A business provides free coffee and snacks in its office break room. What is deductible?

A. One hundred percent as a de minimis fringe to employees
B. Twenty-five percent under the reduced refreshment provision
C. Fifty percent, following the ordinary business meal limitation
D. Nothing, since employee refreshments are personal in nature

40. A corporation has 500,000 of taxable income and 700,000 of book income, with the difference being 200,000 of tax-exempt interest. Which reconciliation entry appears?

A. A subtraction of two hundred thousand from book income
B. An addition of two hundred thousand to book income
C. No entry, because exempt interest never appears on the schedule
D. A subtraction of two hundred thousand from taxable income

41. A partnership allocates 100 percent of depreciation to one partner who has no deficit restoration obligation. What is required?

A. A qualified income offset provision in the partnership agreement
B. Unanimous consent of the partners recorded in the minutes
C. An appraisal supporting the value of the depreciable property
D. A guarantee of the partnership's debts by that same partner

42. A shareholder loans an S corporation 50,000 and the corporation later repays 30,000 when debt basis has been reduced to 20,000. What follows?

A. Ordinary income of thirty thousand on the full repayment
B. A capital loss of ten thousand on the reduced debt basis
C. Ten thousand of income on the portion exceeding debt basis
D. No consequence, since loan repayments are always tax free

43. A business receives 15,000 in cash from a single customer across three related transactions within one week. What is required?

A. Reporting on the cash transaction form within fifteen days
B. Nothing, since no single transaction exceeded the threshold
C. Reporting only where the customer refuses to identify themselves
D. Reporting on the business's own annual income tax return

44. A partnership with 120 partners wishes to elect out of the centralized audit regime. What is the result?

A. It may elect out only with the consent of all its partners
B. It may not elect out, exceeding the one hundred partner limit
C. It may elect out if every partner is an eligible type of person
D. It may elect out only for the first three taxable years

45. A taxpayer converts a rental property with a 200,000 adjusted basis and 170,000 value to personal use. What follows?

A. Depreciation previously claimed is recaptured as ordinary income
B. No gain or loss is recognized on the conversion to personal use
C. A thirty thousand loss is recognized on the conversion date
D. The basis is stepped down to the one hundred seventy thousand value

46. A farmer defers a weather-related sale of breeding cattle. Within what period must replacement occur?

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

47. A private foundation with 4,000,000 of non-exempt-use assets must distribute what?

A. A percentage of the average fair market value of those assets
B. The entirety of its net investment income for the taxable year
C. An amount equal to the contributions it received that year
D. Nothing, provided it makes at least one grant during the year

48. A business with a 30 June year end must file its partnership return by when?

A. The fifteenth day of the fourth month following the year end
B. The fifteenth day of the third month following the year end
C. The fifteenth day of the ninth month following the year end
D. The fifteenth day of the first month following the year end

49. When is a calendar-year C corporation return due?

A. The fifteenth day of the sixth month following the year end
B. The fifteenth day of the ninth month following the year end
C. The fifteenth day of the fourth month following the year end
D. The fifteenth day of the third month following the year end

50. A June year end C corporation faces which special due date rule?

A. An extension of seven months rather than the ordinary six
B. No extension being available for a June fiscal year end
C. A return due the fifteenth day of the third month after year end
D. A return due the fifteenth day of the sixth month after year end

51. A calendar-year S corporation return is due on which date?

A. March fifteenth, the fifteenth day of the third month
B. April fifteenth, the fifteenth day of the fourth month
C. June fifteenth, the fifteenth day of the sixth month
D. September fifteenth following a six-month extension

52. An employer with 40,000 of quarterly employment tax liability in the lookback period deposits how?

A. Semiweekly, following the payday-based deposit schedule
B. Annually, with the employment tax return when it is filed
C. Monthly, by the fifteenth day of the following month
D. Within one business day of each payroll being processed

53. A business accumulates 120,000 of employment tax liability on a single day. What follows?

A. A deposit is required within three business days of that day
B. The liability is deposited with the quarterly return filed
C. The ordinary monthly deposit schedule continues to apply
D. A deposit is required by the next business day following

54. A partnership fails to file for four months with six partners. What is the approximate penalty?

A. A percentage of the partnership's gross receipts for the year
B. No penalty, since the partnership itself owes no tax at all
C. The monthly amount multiplied by six partners and four months
D. A flat amount regardless of the number of partners involved

55. A business discovers it deducted a capital expenditure in the prior year. What is the correction?

A. An amended return for that year, since it is an error rather than a method
B. An application for change in accounting method with an adjustment
C. A prospective change beginning with the current taxable year
D. No correction is required where the amount was immaterial

56. The same business has deducted similar capital expenditures for four consecutive years. What now applies?

A. A method change with a cumulative Section 481(a) adjustment
B. Amended returns for each of the four affected taxable years

C. Prospective correction with no adjustment for earlier years
D. No correction, since the treatment has become established

57. A trust has 20,000 of taxable interest and 10,000 of tax-exempt interest, with 6,000 of trustee fees. What portion of the fees is disallowed?

A. The entire six thousand, being allocable to investment income
B. Three thousand dollars, being half of the fees incurred
C. Two thousand dollars, allocated to the exempt income proportion
D. Nothing, since trustee fees are unique to trust administration

58. A business sells a building for 600,000 with a 350,000 adjusted basis after 150,000 of straight line depreciation. How is the gain taxed?

A. One hundred fifty thousand ordinary and one hundred thousand capital
B. One hundred fifty thousand at the capped rate and the balance capital
C. Two hundred fifty thousand entirely at ordinary income rates
D. Two hundred fifty thousand entirely at long-term capital gain rates

59. A partnership admits a new partner for cash equal to a quarter of the revalued firm. What may the partnership do?

A. Allocate all future income to the incoming partner exclusively
B. Terminate and commence a new partnership for tax purposes
C. Revalue capital accounts to reflect current asset values
D. Distribute the contributed cash immediately without consequence

60. A corporation's earnings and profits are 80,000 and it distributes 200,000 to a shareholder whose basis is 50,000. What results?

A. Eighty thousand dividend, fifty thousand return of capital, seventy thousand gain

B. Two hundred thousand entirely as an ordinary taxable dividend
C. Eighty thousand dividend with the balance deferred indefinitely
D. One hundred fifty thousand dividend and fifty thousand capital gain

61. A business elects out of bonus depreciation for five-year property. What does the election cover?

A. Every class of property placed in service during that year
B. Only the specific assets the taxpayer designates in the election
C. All five-year property placed in service during that year
D. Only property acquired after the date of the election

62. A taxpayer wants to expense one machine and depreciate another of the same class. Which provision permits this?

A. Section 179, elected asset by asset and in partial amounts
B. Bonus depreciation, elected out for the individual machine
C. The de minimis safe harbor applied to one of the two machines
D. A general asset account covering only the chosen machine

63. A business incurs 4,000 to repair storm damage to a roof after claiming a casualty loss. What follows?

A. Half the cost is capitalized and half deducted currently
B. The amount must be capitalized as a restoration of the property
C. The repair remains currently deductible as ordinary maintenance
D. The amount reduces the casualty loss already claimed instead

64. A business exchanges a warehouse for an apartment building of equal value. What follows?

A. Gain is recognized to the extent of the depreciation claimed
B. Only the land portions qualify for the deferral treatment

C. No gain is recognized because both are real property held for business
D. The exchange fails because the properties differ in character

65. The same business receives 40,000 of cash alongside the replacement property. What follows?

A. Gain is recognized to the lesser of realized gain or the boot
B. The cash reduces the basis of the replacement property received
C. The entire exchange becomes taxable because boot was received
D. No gain arises because the properties themselves were like kind

66. A business pays 60,000 for a three-year service contract commencing in December. What is deductible?

A. Twenty thousand dollars, being the first year of the contract
B. Sixty thousand dollars currently under the twelve-month rule
C. The amount must be capitalized and amortized over the term
D. Five thousand dollars, representing the December portion only

67. A business pays 9,000 in December for insurance covering the following calendar year. What is deductible?

A. Nine thousand dollars currently, as the benefit is within twelve months
B. Seven hundred fifty dollars, representing the December month
C. The amount must be capitalized and amortized across the year
D. Four thousand five hundred dollars, being half the premium paid

68. A corporation is owned equally by five individuals and derives seventy percent of its income from rents. What must be checked?

A. Whether the corporation qualifies as an S corporation instead
B. Whether the rents are unrelated business income to the entity

C. Whether the personal holding company income test is satisfied
D. Whether the accumulated earnings tax applies to the retained income

69. A business owner takes 25,000 from the business bank account for personal use. What is the treatment in a proprietorship?

A. Taxable wages subject to income and employment tax withholding
B. A draw with no tax consequence beyond the profit already taxed
C. A deductible business expense reducing net profit for the year
D. A taxable distribution reported on an information return

70. How would the same withdrawal be treated in a C corporation with no formal arrangement?

A. A deductible expense of the corporation reducing its income
B. A tax-free return of the shareholder's original investment
C. A draw with no consequence as in a sole proprietorship
D. Likely a constructive dividend, nondeductible and taxable

71. A shareholder-employee uses a company car sixty percent for business. What does the employer report?

A. Nothing, because business use exceeds fifty percent of total
B. Forty percent of the vehicle's value as taxable wages
C. The full value with the employee deducting the business share
D. The entire annual lease value regardless of the business use

72. A business leases equipment under an arrangement transferring ownership at nominal cost. How is it treated?

A. As a conditional sale, with depreciation and interest to the lessee
B. As a true lease with the rentals deductible as paid

C. As a lease for tax with a purchase only on exercise
D. As neither, since no payment has yet been made

73. A partnership has 200,000 of recourse debt and two general partners sharing losses equally. How is it allocated?

A. According to the partners' respective shares of profits
B. Entirely to the partner with the larger capital account balance
C. One hundred thousand to each under constructive liquidation
D. Equally between recourse and nonrecourse categories first

74. How would 200,000 of nonrecourse debt be allocated between the same partners?

A. Entirely to the partner who negotiated the borrowing arrangement
B. In proportion to the partners' capital account balances
C. According to their respective shares of partnership profits
D. One hundred thousand to each, following the loss sharing ratio

75. A taxpayer sells a business asset at a loss to a fifty-five percent owned corporation. What follows?

A. The loss is deferred until the corporation resells the asset
B. The loss is converted into a capital loss for the year
C. The loss is deductible in full as an ordinary business loss
D. The loss is permanently disallowed under the related party rules

76. A cash-basis business accrues 30,000 owed to a related cash-basis payee. When is it deductible?

A. Immediately, since the amount is fixed and determinable
B. When the related payee includes the amount in income
C. Rateably across the following four taxable years
D. Never, because payments to related parties are disallowed

77. A business writes off a 20,000 receivable from a customer who has ceased trading. What is deductible?

A. Twenty thousand as a short-term capital loss for the year
B. Twenty thousand as a business bad debt reducing ordinary income
C. Nothing where the business uses the cash method of accounting
D. Ten thousand, being half the receivable written off in the year

78. A business holds inventory that has become unsalable following a design change. What may it do?

A. Value the goods at bona fide selling price less disposition cost
B. Deduct the entire cost immediately as an abandonment loss
C. Continue to carry the goods at their original acquisition cost
D. Value the goods at replacement cost of the new design

79. A business claims 100 percent bonus depreciation on qualifying property acquired in 2025. What condition applies?

A. The property must be newly manufactured rather than used
B. Both acquisition and placement in service must fall after a stated date
C. The property must have been acquired from an unrelated party
D. The property must have a recovery period exceeding ten years

80. A business places qualifying property in service in 2025 that was acquired in 2024. What may apply?

A. No bonus depreciation at all where acquisition preceded placement
B. The full percentage applying to property acquired during 2024
C. A reduced percentage determined by the acquisition date
D. The full percentage applying to property placed in service in 2025

81. A partnership makes a Section 754 election in a year with no transfers. What follows?

A. The election applies to all later transfers and distributions
B. The election is void and must be filed again when needed
C. The election expires at the close of that taxable year
D. The election requires annual renewal on each return filed

82. A partner dies holding an interest with a 60,000 outside basis and 200,000 value. What basis does the successor take?

A. One hundred thirty thousand, an average of the two figures
B. Two hundred thousand dollars, stepped up to the date of death value
C. Sixty thousand dollars, being the decedent's carryover basis
D. Zero, with the entire value taxed as income in respect of a decedent

83. An exempt organization receives 50,000 of dividends and 30,000 of debt-financed rental income with a fifty percent debt ratio. What is unrelated business income?

A. Thirty thousand dollars, being the entire rental income received
B. Fifty thousand dollars, being only the dividends received
C. Fifteen thousand dollars, the debt-financed portion of the rents
D. Eighty thousand dollars, both categories being investment income

84. A private foundation pays 20,000 to a disqualified person for genuine consulting services. What follows?

A. Self-dealing regardless of the reasonableness of the amount
B. No consequence, because the services were actually rendered
C. Intermediate sanctions apply as they would to a public charity
D. Excess business holdings tax on the resulting arrangement

85. A farmer elects to defer crop insurance proceeds received in 2025. What must be established?

A. That the crop income would normally have been reported the following year
B. That the insurance company agreed to the deferral in writing
C. That the farmer uses the accrual rather than the cash method
D. That the damage exceeded half the expected annual crop yield

86. A business owner contributes 100,000 to a one-participant plan against 300,000 of net earnings. What must be checked?

A. Whether an annual return becomes due once assets are large enough
B. Whether the plan requires an actuarial certification each year
C. Whether the arrangement is prohibited for a single participant
D. Whether the overall annual additions limit has been exceeded

87. A trust distributes 40,000 to a beneficiary when distributable net income is 25,000, of which 5,000 is exempt interest. What does the beneficiary report?

A. Twenty thousand taxable and five thousand exempt interest
B. Forty thousand dollars, being the full amount received
C. Twenty-five thousand dollars all taxable as ordinary income
D. Fifteen thousand taxable with the balance treated as corpus

88. A business claims the de minimis safe harbor without an applicable financial statement. What per-item ceiling applies?

A. No ceiling, provided the accounting policy is consistently applied
B. A ceiling determined by the taxpayer's own written policy
C. The lower ceiling applying absent an applicable financial statement
D. The higher ceiling available to taxpayers with such a statement

89. A partnership distributes 80,000 of cash to a partner with a 50,000 outside basis. What follows?

A. No gain, because partnership distributions are generally tax free
B. Thirty thousand of gain recognized on the excess over basis
C. Eighty thousand of ordinary income to the receiving partner
D. Thirty thousand suspended until the interest is disposed of

90. A corporation with a June year end must make estimated payments on which dates?

A. September, December, March, and June fifteenths
B. October, December, March, and June fifteenths
C. April, June, September, and December fifteenths
D. The fifteenth day of the fourth, sixth, ninth, and twelfth months

91. A business with 600,000 of average receipts uses the cash method. What must it verify?

A. Whether the business holds any inventory during the year
B. Whether every owner consents to the method being used
C. Whether the business operates in more than one state
D. Whether aggregation with commonly controlled entities crosses the threshold

92. A shareholder guarantees 200,000 of corporate debt and the corporation later defaults, with the shareholder paying 80,000. What follows?

A. Two hundred thousand of basis arises on giving the guarantee
B. Eighty thousand of debt basis arises on the actual payment
C. No basis arises, because guarantees never create shareholder basis
D. Eighty thousand of capital loss arises in the year of payment

93. A farmer receives 90,000 from selling development rights over farmland. How is it treated?

A. Excluded entirely as a conservation-related receipt
B. Ordinary income from the farming business in the year received
C. A reduction in the basis of the land, with gain above basis
D. Section 1231 gain regardless of the land's adjusted basis

94. An exempt organization pays its executive director 300,000 following a board process without comparability data. What risk arises?

A. No risk, because board approval settles the question conclusively
B. A prohibition on paying any compensation for three years
C. Excise taxes without the protection of the presumption
D. Automatic revocation of the organization's exempt status

95. A partnership terminates when its sole remaining business ceases. What happens to its taxable year?

A. The year continues to the ordinary year end regardless
B. The taxable year closes on the date of the termination
C. The year closes only where the partners so elect in writing
D. The year is extended to permit an orderly winding up

96. A business changes from the cash to the accrual method with a 90,000 positive adjustment. How is it reported?

A. Ninety thousand entirely in the year of the accounting change
B. Thirty thousand in each of three consecutive taxable years
C. Twenty-two thousand five hundred in each of four taxable years
D. Nothing, because a change in method has no cumulative effect

97. A corporation has 200,000 of capital gains and 260,000 of capital losses. What is deductible?

A. Three thousand against ordinary income with the balance carried
B. Sixty thousand against ordinary income for the taxable year
C. Two hundred sixty thousand deductible in full for the year
D. Two hundred thousand, with sixty thousand carried back and forward

98. A business owner wishes to deduct a home office used for administrative work only. What is required?

A. The space must be used exclusively and regularly for the business
B. The space must comprise at least ten percent of the residence
C. The space must be the only location where any work is performed
D. The owner must have no other fixed business location at all

99. A trust incurs 12,000 of fiduciary fees and 8,000 of investment advisory fees. What is deductible?

A. Twenty thousand dollars in total against the trust's income
B. Eight thousand of advisory fees only under the current rules
C. Nothing, since both categories are miscellaneous deductions
D. Twelve thousand of fiduciary fees, with advisory fees suspended

100. A business pays 5,000 to settle a claim identified in the order as restitution. What is deductible?

A. Five thousand dollars, identified as restitution in the order
B. Nothing, because payments to a government are never deductible
C. Two thousand five hundred, being half the amount paid
D. The amount only where a court rather than an agency ordered it

Practice Exam 29: Answer Key and Explanations

1. C — Increases bring basis to one hundred forty-four thousand. The distribution and liability decrease together reduce it to one hundred thousand, which is the ceiling on the loss. One hundred thousand is deductible, twenty-four thousand is suspended, and ending basis is exactly zero. Ample basis at each earlier stage does not save the final step.

2. B — Adjusted basis is thirty-three thousand, so gain is fifteen thousand. Recapture is the lesser of depreciation claimed or total gain, and here total gain is smaller. The entire fifteen thousand is ordinary and nothing reaches Section 1231, because gain never exceeded depreciation. Gain never exceeded depreciation, so nothing reaches Section 1231.

3. A — Netting the gains against the losses gives a fifty-five thousand net Section 1231 gain. The lookback then recharacterizes that gain as ordinary to the extent of the twenty thousand of nonrecaptured prior losses, leaving thirty-five thousand as long-term capital gain. Only nonrecaptured losses within the five-year window count. Netting occurs before the lookback rule is ever applied.

4. D — The limit is thirty thousand, being ten percent of taxable income. Current year contributions are used first, absorbing the entire capacity, so none of the carryforward is used. Ten thousand of the current contribution plus the full fifteen thousand carryforward moves forward. Ten thousand of the current gift joins the existing carryforward.

5. C — Thirty-five thousand comes tax free from the adjustments account, reducing basis to thirty-five thousand. Forty thousand is then a dividend not touching basis. The next thirty-five thousand exhausts basis as a return of capital, leaving ten thousand of capital gain. Only the second and third tiers touch the shareholder's basis.

6. D — The income limit is nine thousand. At twenty percent business use the tiers absorb two thousand five hundred of interest and taxes, then one thousand of operating costs, leaving five thousand five hundred, so the entire eight hundred of allocated depreciation is allowed. The total is four thousand three hundred.

7. B — Because the income limitation exceeded the total allocated expenses, nothing was disallowed and nothing carries forward. The personal share of interest and taxes moves to the itemized deductions rather than being carried forward within the home office computation. The personal share moves to itemized deductions instead. Disallowed amounts would otherwise carry to the following year.

8. A — The simplified method applies the published rate to a maximum of three hundred square feet however large the office actually is. No depreciation is claimed and none reduces basis, and the deduction remains limited to the income derived from the business use. No depreciation is claimed and basis remains entirely unreduced.

9. C — The simplified method claims no depreciation, so basis is unreduced but the deduction is forgone, and no carryforward of amounts exceeding the income limit is permitted. Interest and taxes remain fully available as itemized deductions in the ordinary way. Interest and taxes remain available as itemized deductions. No carryforward of excess amounts is permitted under it.

10. A — A cash method taxpayer reports amounts when received regardless of when earned or billed. The December billing produces nothing until February collection, while the November retainer is income immediately even though the services follow in March of the next year. Billing and earning are both irrelevant under the cash method.

11. D — An accrual taxpayer reports the December billing when the right to payment becomes fixed, and reports the advance payment on receipt unless the deferral method is elected. Both therefore land in the earlier year, which reverses the cash method outcome entirely. The advance payment deferral would move it forward one year.

12. B — Fourth quarter placements of one hundred forty thousand represent about sixty-one percent of the two hundred thirty thousand total, comfortably above the forty percent threshold. The mid-quarter convention therefore applies to all personal property placed in service that year. Real property is excluded from the mid-quarter computation. The threshold is measured against the annual aggregate cost.

13. A — Each asset is treated as placed in service at the midpoint of the quarter in which it was actually placed, so the March asset gets ten and a half months of the first year. The November asset by contrast receives only one and a half months. The November asset receives only one and a half months instead.

14. B — Realized gain is forty thousand and the note is boot of twenty-five thousand, so twenty-five thousand is recognized. Stock basis is the seventy thousand property basis, less the twenty-five thousand boot received, plus the twenty-five thousand gain recognized, giving seventy thousand. Boot triggers gain equal to the lesser of realized gain or boot.

15. D — The corporation takes the transferor's basis increased by any gain the transferor recognized, giving seventy thousand plus twenty-five thousand or ninety-five thousand. The step-up matches the gain taxed, so no appreciation is taxed twice across the transaction. No appreciation is therefore taxed twice across the transaction. The corporation's basis reflects the gain the transferor recognized.

16. C — The sixty thousand of precontribution appreciation must be allocated to the contributing partner under Section 704(c). The remaining thirty thousand of post-contribution appreciation is shared according to the partnership agreement in the ordinary way. Post-contribution appreciation follows the partnership agreement. Sixty thousand of precontribution appreciation belongs to the contributor. Several permitted methods exist for making that allocation.

17. D — In a non-liquidating distribution the partner's basis in distributed property cannot exceed outside basis, so the land takes thirty thousand and outside basis falls to zero. No gain arises because property rather than money was distributed. No gain arises because property rather than money was distributed. Outside basis falls to zero and the excess inside basis disappears.

18. B — A corporation that is not a large corporation may base installments on the lesser of the current year estimate or the prior year tax. A quarter of the three hundred twenty thousand prior year figure gives eighty thousand as the minimum first installment. A large corporation would face a materially different rule.

19. C — A large corporation, having taxable income of a million dollars or more in any of the three preceding years, may use the prior year safe harbor only for the first installment. Any resulting shortfall must then be recaptured in the second installment. Any shortfall must be recaptured in the second installment.

20. A — Net earnings are ninety-two and thirty-five hundredths percent of profit, giving roughly one hundred twenty-nine thousand three hundred. Applying the combined rate and halving the result produces approximately nine thousand nine hundred dollars as the adjustment to income. Ninety-two and thirty-five hundredths percent is the operative fraction. The result becomes an adjustment to income on the individual return.

21. A — The deductible half of self-employment tax reduces qualified business income, as do the self-employed health insurance deduction and self-employed retirement contributions attributable to the business. Each reduces the base on which the twenty percent deduction is computed. Health insurance and retirement contributions reduce it as well. Each reduces the base on which twenty percent is computed.

22. C — The residual method fills each class at fair market value in order, so five hundred thousand goes to tangibles and one hundred thousand to the covenant in Class VI. The remaining two hundred thousand becomes goodwill and going concern value in Class VII. Class VII absorbs whatever consideration finally remains.

23. D — Both are Section 197 intangibles amortized ratably over fifteen years from the month of acquisition, regardless of the covenant's shorter stated term. That mismatch between economic and tax life is a persistent point of confusion in acquisitions. The mismatch between economic and tax life confuses many candidates. Both are Section 197 intangibles despite their different lives.

24. B — Compensation of thirty thousand against two hundred fifty thousand of business income invites recharacterization of distributions as wages, with payroll tax, interest, and penalties following. The reasonableness analysis weighs duties, hours, experience, and what comparable positions command. Payroll tax, interest, and penalties all follow from that finding. Duties, hours, experience, and comparable pay drive the analysis.

25. D — Reasonableness turns on the value of services rendered, measured by duties, hours, experience, and comparable pay. A desire to preserve cash or minimize payroll tax is not a factor supporting a low figure and is precisely what the analysis is designed to test. Minimizing payroll tax is precisely what the analysis tests.

26. B — The first-tier beneficiary absorbs twenty-five thousand of distributable net income first. Only thirty-five thousand remains for the second-tier beneficiary, who therefore reports thirty-five thousand despite receiving fifty thousand, with the balance a tax-free distribution of corpus. The balance is a tax-free distribution of trust corpus. First-tier distributions absorb the income before second-tier ones.

27. A — An estate files where gross income is six hundred dollars or more, which this comfortably exceeds. The six hundred dollar exemption reduces taxable income but does not affect the filing obligation, and the two figures are frequently confused by candidates. The exemption reduces taxable income but not the filing duty.

28. C — Gross income of one thousand dollars or more requires filing the business income tax return. Directly connected expenses reduce the four thousand to five hundred, and the one thousand dollar specific deduction then eliminates the taxable amount entirely. The specific deduction eliminates the taxable amount entirely. Gross income of one thousand dollars triggers the filing duty.

29. D — Raised cattle carry a zero basis because raising costs were deducted currently, and thirty months exceeds the twenty-four month requirement for cattle. The entire forty-five thousand is Section 1231 gain, with no depreciation recapture since the animals were never depreciated. Thirty months exceeds the twenty-four month cattle requirement. No recapture arises since the animals were never depreciated.

30. A — Purchased breeding livestock are depreciable, so Section 1245 recaptures depreciation claimed as ordinary income before any Section 1231 treatment. Only gain above the depreciation recaptured receives the more favourable Section 1231 netting treatment. Only gain above the depreciation recaptured reaches Section 1231. Section 1245 applies because purchased animals are depreciable.

31. B — The guaranteed payment is deducted before ordinary income is computed, so if the three hundred thousand is stated after that deduction the partner reports sixty thousand plus twenty-five percent of three hundred thousand, giving one hundred thirty-five thousand in total. The payment is deducted before ordinary income is computed. Twenty-five percent of the stated ordinary income is then added.

32. C — A general partner includes both the guaranteed payment for services and the distributive share of trade or business income in self-employment earnings. A limited partner would generally exclude the distributive share while still including the guaranteed payment. A limited partner would generally exclude the distributive share. Guaranteed payments remain subject for either type of partner.

33. D — The corporation recognizes thirty-five thousand of gain as though it had sold the property at fair market value, which increases its earnings and profits. The shareholder receives a distribution measured at the ninety thousand fair market value and takes that as basis. The gain increases the corporation's earnings and profits too.

34. A — A corporation recognizes gain but never loss on a non-liquidating distribution of property. The twenty thousand economic loss simply disappears, which is why distributing depreciated property is generally avoided in favour of selling it and distributing cash. Selling and distributing cash preserves the loss instead. Gain but never loss is recognized on such a distribution.

35. C — Gross receipts are measured before any deduction including cost of goods sold. The nine hundred thousand figure enters the three-year average tested against the threshold, so a business with thin margins can cross it while earning very little. Thin margins can therefore push a business over the threshold. The three-year average is what the threshold actually tests.

36. B — Basis is tested first and caps the loss at forty thousand. The at-risk figure of sixty-five thousand exceeds that, so it imposes no further limit, and material participation means the passive rules do not apply. Fifty thousand is suspended for want of basis. Fifty thousand is suspended for want of sufficient basis.

37. C — The passive activity rules would apply as the third hurdle, so the forty thousand surviving basis and at-risk would be deductible only against passive income from other sources. Any excess would be suspended until passive income arises or the activity is disposed of. Disposal of the entire interest would release the suspended amount.

38. B — Entertainment expenditure produces no deduction whatever regardless of business purpose. Any food and beverage separately stated on the invoice may qualify for the fifty percent meal deduction, but the entertainment element itself is disallowed in full. Separately stated food may still qualify for the meal deduction. The entertainment element itself is disallowed in full.

39. D — Snacks and beverages provided at the workplace are subject to the fifty percent limitation rather than being fully deductible, following the change that brought employer-operated eating facilities and similar provisions within the limit. They remain excludable to the employees receiving them. They remain excludable to the employees who receive them.

40. A — Tax-exempt interest is book income that never becomes taxable, so it is subtracted from book income in reconciling to taxable income. It nonetheless increases earnings and profits, which is a separate computation with its own entirely different treatment. Earnings and profits treat the same item entirely differently. It nonetheless increases earnings and profits under that measure.

41. A — Without a deficit restoration obligation the allocation can have economic effect only under the alternate test, which requires a qualified income offset and limits allocations to amounts not creating an unexpected deficit in that partner's capital account. Allocations may not create an unexpected deficit in that account. A deficit restoration obligation would remove the requirement.

42. D — Repayment of a shareholder loan whose basis has been reduced by losses produces income to the extent the repayment exceeds the remaining debt basis. Ten thousand is therefore income, with its character depending on whether the debt was evidenced by a written instrument. Character depends on whether a written instrument evidenced it.

43. B — Related transactions are aggregated, so fifteen thousand across one week crosses the ten thousand threshold and must be reported within fifteen days of the transaction that crosses it. Structuring receipts to avoid the threshold is itself a criminal offence. Structuring receipts below the threshold is a criminal offence. Fifteen days runs from the transaction crossing the threshold.

44. C — The partnership must furnish one hundred or fewer Schedules K-1, so one hundred twenty partners defeats the election regardless of their eligibility. An S corporation partner counts by reference to its own shareholders, which can push a partnership over the limit unexpectedly. An S corporation partner counts by its own shareholder number.

45. C — Converting business property to personal use is not a disposition, so no gain, loss, or recapture arises at that moment. Depreciation simply ceases, and the recapture potential remains latent until the property is eventually sold or exchanged. Recapture potential remains latent until an eventual disposal. Depreciation simply ceases from the date of conversion.

46. D — Weather-related sales of draft, breeding, and dairy animals treated as involuntary conversions carry a four-year replacement period, extended further by published notice where drought persists across a region. Animals held for sale instead qualify for a one-year deferral of proceeds. Animals held for sale receive a one-year deferral instead. Published notice extends it where drought persists regionally.

47. A — The distributable amount is a percentage of the average fair market value of assets not used directly in exempt purposes, reduced by the excise tax on net investment income. Failure to distribute by the end of the following year attracts a tax on the shortfall. The excise tax on net investment income reduces the amount.

48. B — A partnership return is due the fifteenth day of the third month after the year end, which for a June year end means September fifteenth. A six-month extension is available, moving it to March fifteenth of the following calendar year. A six-month extension moves it to the following March. September fifteenth applies for a June thirtieth year end.

49. D — A C corporation return is due the fifteenth day of the fourth month after the year end, giving April fifteenth for a calendar year. Partnerships and S corporations file a month earlier, which reflects the need for owners to receive their statements first. Owners must receive their statements before filing their own.

50. C — A corporation with a June thirtieth year end receives a seven-month extension rather than the ordinary six, a transitional provision that survived the general change in due dates. Practitioners with June year end clients are frequently caught out by it. Practitioners with June year end clients are frequently caught out.

51. A — An S corporation files by the fifteenth day of the third month after the year end, matching the partnership deadline and preceding the C corporation date by a month. A six-month extension moves a calendar-year filing to September fifteenth in the ordinary way. A six-month extension moves a calendar-year filing to September fifteenth in the ordinary way.

52. B — Aggregate liability of fifty thousand dollars or less during the lookback period makes the employer a monthly depositor, with deposits due by the fifteenth of the following month. Exceeding that figure produces semiweekly status determined by the day of the week wages are paid. Exceeding that figure produces semiweekly status determined by the day of the week wages are paid.

53. C — Accumulating one hundred thousand dollars or more on any day triggers a next-business-day deposit. A monthly depositor doing so becomes a semiweekly depositor for the remainder of that year and the following one, which is a lasting consequence of a single large payroll. A monthly depositor doing so becomes semiweekly for the remainder of that year and the following one.

54. D — The penalty accrues monthly for each partner during the delinquency, so six partners across four months produces twenty-four partner-months. It applies although the partnership owes no tax, and reasonable cause relief remains available on the facts. It applies although the partnership owes no tax, and reasonable cause relief remains available on the facts.

55. A — A single year's incorrect treatment is an error corrected by amendment, not a method change. Only where the impermissible treatment has been applied consistently across two or more returns does it become a method requiring consent to change. Only consistent treatment across two or more returns establishes a method requiring consent to change.

56. B — Consistent treatment across multiple years establishes a method, however impermissible, so correction requires consent and produces a cumulative adjustment capturing the effect of all earlier years. A positive adjustment spreads across four taxable years. A positive adjustment spreads across four taxable years rather than falling entirely into one. Consent of the Service is required before the change is made.

57. D — Indirect expenses must be allocated between taxable and exempt income. Exempt interest is one third of the thirty thousand total, so two thousand of the six thousand in fees is allocable to it and disallowed, leaving four thousand deductible against taxable income. The allocation reduces deductions available against the trust's taxable income each year.

58. C — Straight line depreciation on real property is not recaptured as ordinary income, but the one hundred fifty thousand attributable to it is unrecaptured Section 1250 gain taxed at a maximum of twenty-five percent. The remaining hundred thousand receives ordinary capital gain rates. The remaining hundred thousand receives ordinary long-term capital gain rates instead.

59. B — The regulations permit revaluing capital accounts on the admission of a partner, restating book capital to current values without affecting tax basis. Subsequent allocations then follow reverse Section 704(c) principles so existing partners retain their built-in gain. Subsequent allocations then follow reverse Section 704(c) principles for the existing partners. Book capital is restated to current values without touching tax basis.

60. A — The first eighty thousand is a dividend to the extent of earnings and profits. The next fifty thousand is a tax-free return of capital exhausting stock basis, and the remaining seventy thousand is capital gain from a deemed sale of the shares. The remaining seventy thousand is capital gain from a deemed sale of the shares.

61. B — The election out applies to an entire class of property for the year rather than asset by asset. A taxpayer wanting selective treatment must instead use Section 179, which may be applied to particular assets and even to partial amounts of a single asset. Section 179 must instead be used where selective treatment within a class is wanted.

62. A — Section 179 is elected affirmatively and may be applied to particular assets and to partial amounts, giving exactly the granularity required. Bonus depreciation operates automatically by class, so it cannot achieve a selective outcome within a single class. Bonus depreciation operates automatically by class and cannot achieve that outcome. Partial amounts of a single asset also qualify.

63. C — An amount paid to restore property for which a casualty loss deduction was claimed is a restoration requiring capitalization. The routine maintenance safe harbor expressly does not reach restorations following a casualty deduction, which surprises many taxpayers. The routine maintenance safe harbor expressly does not reach post-casualty restorations. Betterments and adaptations are likewise outside the safe harbor.

64. D — Real property is broadly like kind to other real property, so a warehouse may be exchanged for an apartment building without recognition. Improved may be exchanged for unimproved and one use for another, provided both are held for business or investment. Improved may be exchanged for unimproved and one use for another entirely.

65. C — Boot triggers recognition of the lesser of realized gain or boot received, so up to forty thousand becomes taxable. The replacement property's basis is the relinquished basis, plus gain recognized, less the boot received in the exchange. Basis is the relinquished basis, plus gain recognized, less the boot received. Up to forty thousand of realized gain therefore becomes taxable.

66. B — The twelve-month rule reaches only prepayments whose benefit does not extend beyond the earlier of twelve months or the following year end. A three-year contract fails that test, so the cost is capitalized and recovered across the period benefited. The cost is capitalized and recovered across the period actually benefited.

67. A — The benefit runs twelve months and ends within the following taxable year, so the twelve-month rule permits current deduction. A cash method taxpayer must also actually pay the amount, which the December payment satisfies for that year. A cash method taxpayer must also have actually paid the amount that year.

68. D — Five or fewer individuals owning more than half the stock satisfies the ownership test. Adjusted income from rents counts as personal holding company income unless it reaches fifty percent of adjusted ordinary gross income and other dividends are limited. Rents count unless they reach fifty percent and other dividends are limited.

69. C — A proprietor's draw is not a deductible expense or a taxable event, because the entire net profit is already taxed to the owner whether withdrawn or not. The withdrawal simply moves already-taxed funds and generates no separate reporting obligation. The withdrawal simply moves already-taxed funds with no separate reporting. Profit is taxed whether withdrawn or not.

70. B — An undocumented withdrawal from a C corporation is likely a constructive dividend, nondeductible by the corporation and fully taxable to the shareholder. Proper documentation as compensation or as a bona fide loan produces materially better outcomes for both parties. Documentation as compensation or a bona fide loan produces better outcomes.

71. D — The employer values total availability and includes it in wages, but the business portion qualifies as a working condition fringe and is excluded. Only the forty percent personal use value therefore becomes taxable compensation to the shareholder-employee. Only the forty percent personal use value becomes taxable compensation. The business share qualifies as an excluded working condition fringe.

72. A — An arrangement transferring ownership for nominal consideration is a conditional sale rather than a lease. The user depreciates the property and deducts the interest element, while the rentals themselves are not deductible as lease payments at all. The rentals themselves are not deductible as lease payments at all. The user depreciates the property and deducts the interest element.

73. B — A constructive liquidation assumes assets become worthless and determines who would bear the economic burden. Two general partners sharing losses equally each bear one hundred thousand, so the recourse debt is allocated equally between them. Two general partners sharing losses equally each bear one hundred thousand. Constructive liquidation assumes the assets become entirely worthless.

74. D — Nonrecourse liabilities are allocated by profit shares rather than loss shares, because no partner bears the economic risk of loss. Where profits and losses are shared differently the two categories of debt therefore produce different allocations entirely. Differing profit and loss ratios therefore produce different allocations. No partner bears the economic risk of loss on nonrecourse debt.

75. C — Ownership exceeding fifty percent makes the corporation a related party, so the loss is disallowed entirely. The disallowed amount may reduce the corporation's gain on a later resale to an outsider, so the benefit shifts to the purchaser. The disallowed amount may reduce the corporation's gain on a later resale.

76. A — The matching rule defers the deduction until the related payee includes the amount in income, preventing a deduction in one year while the corresponding income is deferred. The payee's own method of accounting therefore controls the payer's deduction timing. The payee's own method of accounting controls the payer's timing. Deduction and inclusion are thereby matched between the parties.

77. B — A cash method business never included the receivable in income, so writing it off produces no deduction at all. An accrual business that included the amount deducts it as a business bad debt reducing ordinary income when it becomes worthless. An accrual business that included the amount deducts it when worthless.

78. A — Subnormal goods unsalable at normal prices because of damage, imperfection, or similar causes may be valued at bona fide selling price less direct disposition cost. The taxpayer must be able to demonstrate the goods genuinely fall within that description. The taxpayer must demonstrate the goods genuinely fall within that description.

79. C — The applicable percentage turns on when the property was both acquired and placed in service, which creates a gap period trap for property acquired earlier and placed in service later. Used property qualifies provided it is new to the taxpayer and not from a related party. Used property qualifies where new to the taxpayer and not from a related party.

80. D — The percentage is determined by the acquisition date rather than the placement date, so property acquired in an earlier year carries that year's percentage even where it is placed in service later.

The distinction matters greatly in a year when the percentage changes. The distinction matters greatly in a year when the percentage changes.

81. B — Once made the election applies to all subsequent transfers and distributions until revoked with consent. The administrative burden of tracking separate adjustments for individual partners is why partnerships often hesitate before making it at all. Tracking separate adjustments for individual partners is the practical burden. Revocation requires the consent of the Service once it is made.

82. C — The successor takes a basis stepped up to the date of death value for the interest itself. Any inside basis disparity is corrected only where a Section 754 election is in place, without which the successor's outside and inside basis remain mismatched. Without an election the successor's outside and inside basis stay mismatched.

83. D — Dividends are excluded as passive income. The rental income is debt-financed to the extent of the fifty percent ratio, so fifteen thousand of the thirty thousand enters unrelated business taxable income before the specific deduction is applied. The specific deduction is then applied against that computed amount. Dividends are excluded from unrelated business income as passive.

84. A — Self-dealing between a private foundation and a disqualified person is prohibited largely without regard to fairness, though reasonable compensation for personal services necessary to exempt purposes is a narrow exception. Consulting arrangements are scrutinized closely against that exception. Reasonable compensation for necessary personal services is a narrow exception. Consulting arrangements are scrutinized closely against that exception.

85. A — The farmer must establish that under normal practice the income from the damaged crops would have been reported in the following year. Only a cash method farmer may make the election, and it applies to all such proceeds for the year. Only a cash method farmer may make it, and it covers all such proceeds.

86. C — The combined employee deferral and employer contribution cannot exceed the annual additions limit, tested against compensation computed after the deductible half of self-employment tax. A separate filing obligation arises once plan assets exceed the stated threshold. A separate filing obligation arises once plan assets exceed the threshold. Compensation is computed after the deductible half of self-employment tax.

87. B — The distribution carries out distributable net income of twenty-five thousand, proportionately across the classes. The beneficiary reports twenty thousand of taxable income and five thousand of exempt interest, with the remaining fifteen thousand a tax-free distribution of corpus. The remaining fifteen thousand is a tax-free distribution of trust corpus. Distributable net income is carried out proportionately across classes.

88. D — The per-item ceiling is materially lower without an applicable financial statement, and a written accounting policy must be in place at the start of the year. That difference often determines whether the election is worth making for a smaller business. A written accounting policy must be in place at the start of the year.

89. B — Money distributed in excess of outside basis produces gain, generally capital, of thirty thousand here. Marketable securities are usually treated as money for this rule, so distributing publicly traded stock produces the same outcome as distributing cash. Marketable securities are usually treated as money for this same rule. The gain arising on such an excess is generally capital in character.

90. A — Installments fall on the fifteenth day of the fourth, sixth, ninth, and twelfth months of the taxable year, which for a June year end means October, December, March, and June. The pattern follows the fiscal year rather than the calendar. The pattern follows the fiscal year rather than the calendar year.

91. D — Gross receipts of businesses under common control or in an affiliated service group are aggregated before the three-year average is computed. A business comfortably below the threshold on its own can therefore cross it once related entities are combined. A business below the threshold alone can cross it once combined.

92. C — A guarantee produces no basis until it is called and the shareholder actually pays, at which point the payment creates debt basis to that extent. The shareholder becomes a creditor of the corporation, which is the economic outlay the rules require. The shareholder becomes a creditor, which is the outlay required.

93. B — A sale of development rights is generally treated as a sale of an interest in the land, reducing basis with gain arising above it. A donation of the same rights by contrast may support a qualified conservation contribution deduction instead. Donating the same rights may instead support a conservation deduction.

94. D — Without comparability data and adequate documentation the rebuttable presumption of reasonableness is unavailable, leaving the organization exposed to intermediate sanctions if the amount proves excessive. The burden then rests on the organization rather than the Service. The burden then rests on the organization rather than the Service. Comparability data and adequate documentation are both required.

95. A — The partnership's taxable year closes on termination, and the final return covers the short period ending that day. Termination now requires that no part of any business continue to be carried on by any partner in a partnership. The final return covers the short period ending on that day. Termination requires that no part of any business continue in partnership.

96. C — A positive Section 481 adjustment increasing income spreads ratably over four taxable years beginning with the year of change, giving twenty-two thousand five hundred annually. A negative adjustment decreasing income would instead be taken entirely in the year of change. A negative adjustment would instead be taken entirely in that year.

97. B — A corporation deducts capital losses only against capital gains, so two hundred thousand is absorbed and sixty thousand carries back three years and forward five. Carried amounts are treated as short-term regardless of their original character. Carried amounts are short-term regardless of their original character. Sixty thousand carries back three years and forward five years.

98. C — Exclusive and regular use for the trade or business is required, together with the space being the principal place of business, which administrative use qualifies for where no other fixed location is used substantially for those activities. Any personal use of the space defeats the deduction. Any personal use of the space defeats the deduction entirely.

99. D — Costs that would not have been incurred but for the property being held in trust survived the suspension, so fiduciary fees remain deductible. Investment advisory fees of a kind individuals commonly incur fall outside that carve-out and are currently disallowed entirely. Ordinary investment advisory fees are currently disallowed entirely. Fiduciary fees would not have arisen but for the trust itself.

100. A — Amounts constituting restitution, remediation, or coming into compliance may be deducted where identified as such in the settlement agreement or order. The identification requirement is strict, which makes the drafting of the document itself genuinely consequential. Drafting of the settlement document is therefore genuinely consequential. Fines and similar penalties otherwise remain wholly nondeductible.