PRACTICE EXAM 30: 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. Immediately before a 95,000 dollar discharge, a business has 380,000 of liabilities and 410,000 of assets. How much is excluded?

A. Thirty thousand dollars, the amount of the equity surplus
B. Nothing, because the taxpayer was solvent before the discharge
C. Ninety-five thousand dollars under the insolvency exclusion
D. Sixty-five thousand dollars, the balance after the surplus

2. A partner sells an interest for 260,000 with a 150,000 outside basis. Partnership receivables are 40,000 and inventory 25,000 attributable to that interest. How is the gain characterized?

A. Sixty-five thousand capital and forty-five thousand ordinary
B. One hundred ten thousand dollars entirely as ordinary income
C. Sixty-five thousand ordinary and forty-five thousand capital
D. One hundred ten thousand dollars entirely as capital gain

3. A corporation owning eight percent of a payer receives 150,000 of dividends with 120,000 of taxable income before the deduction. What is deductible?

A. Sixty thousand dollars, applying the taxable income limitation

B. Seventy-five thousand dollars, being fifty percent of dividends
C. One hundred fifty thousand dollars, the entire amount received
D. One hundred twenty thousand dollars, equal to taxable income

4. A corporation with a 500,000 net operating loss carryforward has 400,000 of taxable income before the deduction. What is the result?

A. Three hundred twenty thousand used, leaving 80,000 of income
B. Five hundred thousand used, producing a one hundred thousand loss
C. Four hundred thousand used, reducing taxable income to zero
D. Two hundred thousand used, being half the available carryforward

5. A business elects 400,000 of Section 179 expense against 250,000 of aggregate business taxable income. What follows?

A. Two hundred fifty thousand deducted with the balance lost
B. Two hundred fifty thousand deducted with 150,000 carried forward
C. Four hundred thousand deducted, creating a business loss
D. No deduction, because the election exceeds available income

6. A taxpayer below the threshold has 180,000 of qualified business income, 150,000 of taxable income, and 30,000 of net capital gain. What is the deduction?

A. Twenty-four thousand dollars under the taxable income cap
B. Thirty-six thousand dollars, being twenty percent of the income
C. Thirty thousand dollars, being twenty percent of taxable income
D. Nothing, because taxable income is less than qualified income

7. Which credit amount shelters accumulations by a general corporation?

A. Two hundred fifty thousand dollars as a presumptive floor

B. One hundred fifty thousand dollars as a presumptive floor
C. No fixed amount, since the test is entirely factual
D. An amount equal to one year's operating expenses

8. A self-employed taxpayer whose prior year adjusted gross income was well above the threshold seeks a safe harbor. What percentage applies?

A. One hundred percent of the prior year tax in every case
B. One hundred percent of the current year expected liability
C. One hundred ten percent of the prior year tax liability
D. Ninety percent of the prior year tax shown on that return

9. A calendar-year individual with business income makes estimated payments on which dates?

A. The last day of each calendar quarter during the year
B. April, June, September, and December fifteenths
C. April and June fifteenths, September fifteenth, and January fifteenth
D. March, June, September, and December fifteenths

10. A partnership has 400,000 of ordinary income and pays 90,000 of guaranteed payments to one partner. What is the partnership's deduction?

A. Ninety thousand deducted before ordinary income is computed
B. Nothing, since guaranteed payments are distributions of profit
C. Forty-five thousand, being half the guaranteed payment made
D. Ninety thousand deducted only where the partner is a limited partner

11. A corporation distributes 60,000 to a shareholder when current earnings are 25,000 and accumulated earnings show a 40,000 deficit. What is the dividend?

A. Twenty-five thousand dollars from current earnings and profits

B. Nothing, because the deficit exceeds the current earnings
C. Sixty thousand dollars, the entire distribution being taxable
D. Thirty-five thousand dollars, netting the two pools together

12. A shareholder-employee earns 150,000 of wages and the S corporation allocates 200,000 of ordinary income. What is subject to self-employment tax?

A. Two hundred thousand, being the distributive share allocated
B. Neither amount, though the wages bear payroll tax as wages
C. Both amounts, since the shareholder works in the business
D. One hundred fifty thousand, being the wages actually paid

13. A business purchases a machine for 80,000 and trades in an old machine worth 12,000 with a 5,000 basis. What follows?

A. Gain of seven thousand recognized with an eighty thousand basis
B. No gain recognized, with the new basis reduced by the trade-in
C. Gain of twelve thousand recognized on the machine surrendered
D. No gain recognized, with a carryover basis of seventy-three thousand

14. A partnership incurs 8,000 of organizational costs and 62,000 of start-up costs. What is deducted immediately?

A. Seventy thousand dollars, both categories deducted in full
B. Five thousand from organizational costs and nothing from start-up
C. Ten thousand dollars, five thousand from each category
D. Five thousand from start-up costs and nothing from organizational

15. What is amortized in that situation and over what period?

A. Sixty-five thousand across one hundred eighty months from opening

B. Seventy thousand across one hundred eighty months from formation
C. Fifty-seven thousand across sixty months from the opening date
D. Three thousand across one hundred eighty months from formation

16. A trust with 50,000 of distributable net income makes no distributions. What follows?

A. The income is deferred until the trust eventually distributes
B. The income is exempt because no beneficiary received it
C. The trust pays tax on the income at compressed trust rates
D. The beneficiaries report the income proportionately anyway

17. A business owner sells goodwill for 300,000 with no basis as part of an asset sale. How is it taxed?

A. Long-term capital gain where the goodwill was held over a year
B. Ordinary income, since goodwill is a Section 197 intangible
C. Section 1231 gain netted against other business dispositions
D. Ordinary income to the extent of amortization previously claimed

18. A business acquires an existing customer list for 90,000 and amortizes 30,000 before selling it for 100,000. What is recognized?

A. Forty thousand gain, with thirty thousand recaptured as ordinary
B. Ten thousand gain treated entirely as long-term capital gain
C. One hundred thousand ordinary income on the disposition
D. Forty thousand gain treated entirely as capital in character

19. A business has 40,000 of business interest expense, 5,000 of business interest income, and 90,000 of adjusted taxable income. What is deductible?

A. Five thousand only, matching the business interest income
B. Thirty-two thousand, the sum of income and thirty percent

C. Forty thousand dollars, since the cap is not actually reached
D. Twenty-seven thousand, being thirty percent of adjusted income

20. Which taxpayer avoids that limitation entirely?

A. One electing to capitalize interest into inventory instead
B. One meeting the average annual gross receipts test
C. One whose interest expense falls below the annual dollar cap
D. One whose business is conducted through a partnership

21. A business acquires equipment on 15 December for 200,000 and places it in service on 5 January. Which year does it depreciate?

A. The later year, when the property was placed in service
B. The earlier year, since the acquisition occurred in December
C. Both years proportionately across the two taxable periods
D. Neither year until the equipment is actually used in production

22. A business writes a 25,000 check on 31 December that clears on 6 January. When is it deductible?

A. Proportionately across the two years by days elapsed
B. In the earlier year, when the check was delivered or mailed
C. In the later year, when the check actually cleared the bank
D. In neither year, since the payment straddles the year end

23. A partnership allocates a 60,000 loss to a partner with 45,000 of basis, 45,000 at risk, and 20,000 of passive income. What is deductible?

A. Forty-five thousand, limited by basis and the at-risk figure
B. Fifteen thousand, being the loss net of the passive income
C. Twenty thousand, limited by the passive income available

D. Sixty thousand, since basis and at-risk both exceed the loss

24. A corporation redeems thirty percent of a sole shareholder's stock. What follows?

A. Dividend treatment, since the shareholder's proportion is unchanged
B. Exchange treatment, because a substantial block was redeemed
C. Partial liquidation treatment on the corporate contraction
D. Capital gain measured against the redeemed shares' basis

25. A business sells inventory to a fifty-five percent owned corporation at a 30,000 loss. What follows?

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

26. A trust distributes all of its 40,000 of income and makes no charitable gifts or corpus distributions. What is it for that year?

A. A grantor trust taxed entirely to the settlor of the trust
B. An electing small business trust for that taxable year
C. A simple trust, satisfying all three of the conditions
D. A complex trust because of the size of the distribution

27. An exempt organization operates a gift shop staffed entirely by paid employees, open year round. What follows?

A. Excluded because the proceeds fund the exempt purpose
B. Unrelated business income, since no exception applies to it
C. Excluded from unrelated business income as a convenience activity
D. Excluded under the volunteer labour exception to the tax

28. A farmer with 60,000 of farm income elects to average 40,000 across three base years. What is the effect?

A. The elected amount is taxed using unused base year brackets
B. Farm income is excluded entirely from the current year return
C. The base year returns must each be amended accordingly
D. The tax rate on all income is reduced by a fixed percentage

29. A business has average annual gross receipts of 22,000,000 and holds substantial inventory. What is required?

A. The accrual method, inventory accounting, and capitalization
B. The cash method with inventory treated as materials and supplies
C. The accrual method only, with inventory relief still available
D. A choice between the cash and accrual methods each year

30. A shareholder contributes 50,000 of cash and a 90,000 mortgage-encumbered building with an 80,000 basis to a corporation for all its stock. What gain arises?

A. Ten thousand dollars, the liability exceeding the property basis
B. Ten thousand dollars, the appreciation in the building
C. No gain arises where control is present after the exchange
D. Ninety thousand dollars, the entire liability assumed

31. A partnership distributes inventory with a 20,000 basis to a partner who sells it two years later at a 15,000 gain. How is that gain characterized?

A. Section 1231 gain netted with other business dispositions
B. Ordinary income, since the five-year period has not expired
C. Capital gain, because more than five years have not elapsed

D. Half ordinary and half capital under a proportionate rule

32. A business claims a 12,000 casualty loss on equipment and later receives 9,000 of insurance. What follows?

A. The insurance reduces the basis of the replacement equipment
B. An amended return must be filed for the earlier loss year
C. The recovery is income to the extent the loss produced benefit
D. The insurance is excluded as a recovery of a capital item

33. An S corporation with accumulated earnings has 300,000 of gross receipts of which 90,000 is passive investment income. What follows?

A. No consequence, because the proportion is below the threshold
B. Exposure to the passive investment income tax on the excess
C. Immediate termination of the S election for that taxable year
D. Mandatory distribution of the accumulated earnings and profits

34. A corporation accrues a 40,000 bonus to a fifty-one percent shareholder-employee in December, paying it in March. When is it deductible?

A. In the year the shareholder-employee actually includes it in income
B. In the accrual year, because payment fell within two and a half months
C. Rateably across both the accrual year and the payment year
D. Never, since bonuses to a controlling shareholder are wholly disallowed

35. A partnership admits a partner who contributes services for a twenty percent profits interest. What follows?

A. Generally no immediate income under published safe harbor guidance
B. Immediate ordinary income equal to twenty percent of net assets

C. Capital gain measured by the projected future distributions
D. Deferred income recognized when the first distribution is made

36. A business receives a 20,000 state grant to offset the cost of new equipment. What follows?

A. The grant is excluded entirely with no basis consequence
B. The grant is ordinary income with full basis retained
C. The grant is capital gain in the year it is received
D. The grant reduces the equipment's depreciable basis

37. A business owner with two separate trades wishes to aggregate them for the deduction. What is required?

A. Common ownership, coordination, and neither being a service business
B. Written consent from every owner of each of the businesses
C. The businesses operating within the same state jurisdiction
D. Approval of the aggregation by the Service before filing

38. A shareholder's S corporation stock basis is 30,000 and debt basis 20,000 when a 65,000 loss is allocated. What is suspended?

A. Fifteen thousand, with both bases reduced to zero first
B. Thirty-five thousand, since only stock basis absorbs losses
C. Sixty-five thousand, because losses cannot exceed contributions
D. Nothing, since the combined bases exceed the allocated loss

39. A corporation with 800,000 of receipts and 40,000 of taxable income makes a 90,000 charitable contribution. What is deductible?

A. Eighty thousand dollars, being ten percent of gross receipts
B. Forty thousand dollars, equal to the taxable income figure

C. Four thousand dollars, being ten percent of taxable income
D. Ninety thousand dollars, the full contribution made

40. A partnership terminates and distributes 60,000 of cash to a partner with an 85,000 outside basis. What follows?

A. Twenty-five thousand of ordinary loss on the liquidation
B. Twenty-five thousand added to the partner's remaining assets
C. No loss recognized, with the excess basis simply disappearing
D. Twenty-five thousand of capital loss recognized on liquidation

41. A business uses a vehicle 8,000 miles for business and 4,000 for personal purposes. What portion of actual costs is deductible?

A. Two thirds of the actual costs incurred during the year
B. The entire cost, with the personal element added to wages
C. Half the actual costs under a standard allocation rule
D. Nothing, since the standard mileage rate must be used

42. An exempt organization receives a 5,000 payment for naming rights with no comparative advertising. What follows?

A. Excluded as investment income under the passive exclusion
B. Taxable to the extent the payment exceeds the event's cost
C. A qualified sponsorship payment excluded from taxable income
D. Unrelated business income, since naming rights are advertising

43. A farmer purchases breeding stock for 60,000, claims 25,000 of depreciation, and sells for 70,000. How is the gain characterized?

A. Twenty-five thousand ordinary and ten thousand Section 1231

B. Thirty-five thousand entirely as Section 1231 gain on livestock
C. Seventy thousand ordinary because livestock are inventory
D. Ten thousand ordinary and twenty-five thousand Section 1231

44. A business has 15,000 of meals with clients and 6,000 of office snacks. What is deductible?

A. Seven thousand five hundred, only the client meals at half
B. Ten thousand five hundred dollars across both categories
C. Twenty-one thousand dollars, all being business food costs
D. Fifteen thousand for client meals and nothing for snacks

45. A corporation has 250,000 of book income including 30,000 of exempt interest and excluding 45,000 of federal tax expense recorded. What is taxable income?

A. Two hundred twenty thousand after removing the exempt interest
B. Two hundred ninety-five thousand, adding back the tax expense
C. Two hundred sixty-five thousand after both reconciling items
D. Two hundred fifty thousand dollars, matching the book figure

46. A business claims 50,000 of bonus depreciation creating a 20,000 loss. What follows?

A. The excess must be capitalized and recovered in later years
B. The loss is permitted, since bonus carries no income limitation
C. The bonus deduction is limited to the amount of income available
D. The taxpayer must elect out of bonus for that entire class

47. A partnership has a 100,000 recourse liability and one general and one limited partner. How is it allocated?

A. Entirely to the general partner bearing the economic risk
B. Fifty thousand to each partner under the profit sharing ratio

C. In proportion to each partner's capital account balance
D. Entirely to the limited partner who contributed the capital

48. A shareholder receives property worth 55,000 with a 70,000 basis in an S corporation distribution. What does the corporation recognize?

A. No loss, since loss is never recognized on a distribution
B. Fifteen thousand of loss passing through to shareholders
C. Fifteen thousand of loss deductible at the corporate level
D. Fifty-five thousand of gain measured at fair market value

49. A business owner takes a 40,000 loan from their solely owned C corporation with a note, market interest, and a fixed maturity. What follows?

A. Respected as a loan with interest income to the corporation
B. Treated as a constructive dividend despite the documentation
C. Treated as additional compensation subject to payroll tax
D. Treated as a return of the shareholder's original capital

50. A trust incurs 5,000 of expenses allocable to 25,000 of exempt interest out of 100,000 of total income. What portion is disallowed?

A. Two thousand five hundred, being half of the expenses
B. Five thousand dollars, the entire directly allocable amount
C. Nothing, since the expenses relate to trust administration
D. One thousand two hundred fifty, the exempt proportion

51. A business places 300,000 of qualified improvement property in service. What recovery period applies?

A. Twenty-seven and a half years under the residential provision

B. Twenty years, matching general purpose agricultural structures
C. Fifteen years, with Section 179 expensing also available
D. Thirty-nine years, as with the underlying nonresidential building

52. Which improvement is excluded from that classification?

A. Interior electrical work performed after the building opened
B. An interior partition installed in leased office premises
C. An enlargement of the building's total floor area
D. Replacement of interior lighting throughout a floor

53. A partnership has 500,000 of debt-financed property producing 80,000 of income with a forty percent average acquisition indebtedness ratio. What is unrelated to an exempt partner?

A. Thirty-two thousand dollars, the debt-financed proportion
B. Eighty thousand dollars, the entire income from the property
C. Twenty thousand dollars, being a quarter of the income
D. Nothing, since partnership income retains its passive character

54. A corporation's shareholder dies holding stock worth 500,000 with a 100,000 basis, and the estate redeems shares to pay 180,000 of death taxes. What follows?

A. Capital gain measured against the decedent's original basis
B. No gain, since the redemption is exempt from taxation entirely
C. Exchange treatment on the redemption up to that amount
D. Ordinary dividend treatment on the entire redemption amount

55. A business owner works 600 hours in one activity and 150 hours in another where no one works more. What follows?

A. Neither activity satisfies any of the participation tests

B. Material participation in both under separate applicable tests
C. Material participation in the first activity only for the year
D. Material participation only where the two are grouped together

56. A corporation has 2,000,000 of receipts and pays its sole shareholder-officer 900,000 in a year of modest profit. What risk arises?

A. Loss of the corporation's own deduction for all compensation
B. Recharacterization of the salary as a nondeductible dividend
C. Recharacterization of distributions as additional taxable wages
D. Imposition of the accumulated earnings tax on the retention

57. A partnership pays 30,000 to a partner for architectural services rendered in a non-partner capacity. What follows?

A. Treated as a distributive share of partnership ordinary income
B. Treated as a distribution reducing the partner's outside basis
C. Treated as a payment to an unrelated party for those services
D. Treated as a guaranteed payment reported on the Schedule K-1

58. A business has a 60,000 general business credit and 45,000 of net income tax. What follows?

A. Forty-five thousand claimed with the excess permanently lost
B. Forty-five thousand claimed with fifteen thousand carried
C. Sixty thousand claimed with the excess refunded to the taxpayer
D. Thirty thousand claimed under a fifty percent limitation

59. A farmer defers 50,000 of livestock sale proceeds under the weather-related provisions. What must be established?

A. That the sale exceeded normal business practice because of weather

B. That the region was formally designated as a disaster area
C. That replacement animals were purchased before the year ended
D. That the farmer uses the accrual method of accounting

60. A business owner contributes appreciated inventory worth 40,000 with a 15,000 basis to a charity serving the needy. What is deductible?

A. Twenty-seven thousand five hundred, basis plus half the gain
B. Forty thousand dollars, being the full fair market value
C. Thirty thousand dollars, being twice the property's basis
D. Fifteen thousand dollars, limited to the taxpayer's basis

61. A trust sells property held for investment at a 30,000 loss with no capital gains. What is deductible?

A. Fifteen thousand dollars under a proportionate allowance
B. Nothing, since trusts may never deduct any capital losses
C. Three thousand dollars with the balance carried forward
D. Thirty thousand dollars against the trust's ordinary income

62. An exempt organization has 6,000 of income from one unrelated business and a 4,000 loss from another. What is taxable?

A. Nothing, because the specific deduction covers the amount
B. Five thousand after the specific deduction is applied
C. Two thousand dollars, after netting the two activities
D. Six thousand before the specific deduction is applied

63. A shareholder's S corporation stock basis is zero when the corporation allocates 40,000 of income and distributes 35,000. What follows?

A. Forty thousand of income with the distribution being taxable

B. Thirty-five thousand of capital gain on the distribution received
C. Forty thousand of income and a tax-free distribution
D. Nothing, because basis was zero at the start of the year

64. A business acquires a 40 percent interest in a partnership by purchase for 200,000 when its share of inside basis is 140,000. What is available?

A. No adjustment, since inside and outside basis always correspond
B. An adjustment of sixty thousand only where the partnership elects
C. An adjustment of two hundred thousand replacing the inside share
D. A mandatory adjustment regardless of any election in place

65. A business receives 200,000 for agreeing not to compete for five years. How is it taxed?

A. Ordinary income spread across the five-year covenant period
B. Ordinary income in full in the year the payment is received
C. Capital gain measured against the goodwill's adjusted basis
D. Section 1231 gain netted with other business dispositions

66. A business owner takes 80,000 of salary from an S corporation earning 400,000 in a capital-intensive manufacturing operation. What follows?

A. Reasonableness turns on services rendered rather than profits
B. The distributions are automatically recharacterized as wages
C. The salary must equal at least half the corporation's income
D. The S election terminates for inadequate compensation

67. A partnership distributes property to a partner within two years of that partner contributing cash. What may follow?

A. Recharacterization of the two steps as a disguised sale

B. Automatic termination of the partnership for tax purposes
C. Immediate recognition of all built-in gain by the partnership
D. Loss of the partnership's ability to make special allocations

68. A business capitalizes 60,000 of interest during construction of its own facility. What follows?

A. The interest is amortized separately over sixty months
B. The interest enters the facility's basis and is recovered through depreciation
C. The interest is deducted currently despite the capitalization
D. The interest is added to the land basis and never recovered

69. A trust makes a 20,000 distribution to a beneficiary in the first sixty-five days of the year. What may the fiduciary elect?

A. To defer the distribution's effect to the following taxable year
B. To treat the distribution as made on the last day of the prior year
C. To allocate the distribution equally across both taxable years
D. To treat the distribution as a tax-free return of trust corpus

70. A business has 500,000 of gross receipts, 300,000 of cost of goods sold, and average receipts of 26,000,000 over three years. What applies?

A. The accrual method and inventory accounting for the year
B. The cash method, since current year receipts are modest
C. The cash method with inventory as materials and supplies
D. A choice of method, since the current year is below the threshold

71. An employer reclassifies a worker as an employee after three years of contractor treatment. What relief may apply?

A. Automatic reduction of liability to half the amount owed

B. Section 530 relief where the three conditions are satisfied
C. Complete forgiveness of all prior employment tax liability
D. Deferral of the liability across the following three years

72. A corporation with 900,000 of accumulated earnings retains cash for a documented expansion plan. What follows?

A. A specific plan supports reasonable business needs against the tax
B. The corporation must distribute the excess within one year
C. The accumulated earnings credit is forfeited by the retention
D. The accumulated earnings tax applies to the entire retained amount

73. A partnership allocates 90 percent of losses to one partner who has contributed 10 percent of capital. What must be established?

A. Substantial economic effect through the capital account rules
B. Unanimous written consent of all partners to the allocation
C. That the allocation matches the partners' profit sharing ratios
D. That the partnership obtained a ruling before allocating

74. A business sells equipment on an installment basis with 45,000 of depreciation recapture and 20,000 of additional gain. What is recognized in year one?

A. Forty-five thousand of recapture regardless of payments received
B. Sixty-five thousand dollars, being the entire gain realized
C. Nothing, since all gain is deferred under the installment method
D. Thirteen thousand, being a proportionate share of the total

75. A business has 12,000 of qualified research expenses and elects the payroll offset. What is required?

A. A prior election in each of the preceding five taxable years

B. At least ten employees performing the qualified research
C. Qualified small business status with receipts below the limit
D. Gross receipts exceeding the threshold in the current year

76. A partnership has 150,000 of nonrecourse deductions and no partner bears risk. What allocation rule applies?

A. Allocation according to the partners' loss sharing arrangement
B. Allocation by profit shares with a minimum gain chargeback
C. Allocation entirely to the partner with the largest capital account
D. Allocation prohibited entirely because no risk is borne

77. A business owner uses 400 square feet of a 2,000 square foot home exclusively as an office and elects the simplified method. What is the deduction?

A. Twenty percent of all actual home expenses for the year
B. The published rate applied to 300 square feet at most
C. The published rate applied to the entire 400 square feet
D. Nothing, since the area exceeds the simplified method cap

78. A corporation liquidates distributing assets worth 900,000 with a 400,000 basis to a shareholder with a 250,000 stock basis. What total gain arises?

A. Six hundred fifty thousand at the shareholder level only
B. Five hundred thousand corporate and six hundred fifty thousand shareholder
C. Nine hundred thousand at the corporate level with no shareholder gain
D. Five hundred thousand at the corporate level only

79. A farmer elects out of the uniform capitalization rules for a vineyard. What is the cost?

A. Mandatory use of the accrual method for the farming business

B. Loss of the ability to deduct any preproductive period costs
C. Use of the alternative depreciation system for all farm assets
D. A ten-year commitment to remain in the farming business

80. A business receives 40,000 in cash from one customer in four related payments over a fortnight. What is required?

A. Nothing, since no individual payment exceeded the threshold
B. Reporting only where the customer declines to provide identification
C. Reporting on the business income tax return for the year
D. Reporting on the cash form within fifteen days of crossing it

81. An exempt organization pays 200,000 to a board member's company for services worth 120,000. What follows?

A. No consequence where the board approved the arrangement
B. A requirement to report the payment as a program expense
C. Excise taxes on the excess benefit and possibly on managers
D. Automatic revocation of the organization's exempt status

82. A business owner dies holding a partnership interest, and the partnership has a Section 754 election. What follows?

A. The successor's inside basis share is adjusted to match outside basis
B. The partnership terminates on the date of the partner's death
C. The successor takes the decedent's original carryover basis
D. No adjustment is available where the transfer occurs at death

83. A corporation has 100,000 of taxable income and 30,000 of foreign taxes on 80,000 of foreign source income. What limits the credit?

A. The total amount of foreign taxes actually paid during the year
B. The proportion foreign source income bears to total taxable income
C. Fifty percent of the corporation's total income tax liability
D. The corporation's own election between credit and deduction

84. A business changes its accounting method and computes a 40,000 negative adjustment. How is it reported?

A. Forty thousand entirely in the year the change occurs
B. Twenty thousand in each of two consecutive taxable years
C. Ten thousand in each of four consecutive taxable years
D. Nothing, since only positive adjustments are recognized

85. A partnership has 80 direct partners including an S corporation with 40 shareholders. May it elect out?

A. Yes, provided every direct partner consents to the election
B. No, because an S corporation partner is an ineligible person
C. No, because the statement count reaches one hundred twenty
D. Yes, because the direct partner count is below one hundred

86. A business owner materially participates in a rental activity averaging four days of customer use. What follows?

A. Losses are deductible because it is not a rental activity
B. The activity is per se passive regardless of participation
C. Only the special allowance for rental real estate is available
D. The activity is passive unless the owner is a real estate professional

87. A corporation contributes 25,000 to a political campaign committee. What is deductible?

A. Nothing, since political contributions are wholly nondeductible
B. Twenty-five thousand as an ordinary business expense
C. Twelve thousand five hundred under a partial allowance
D. Twenty-five thousand where a business purpose is documented

88. A shareholder loans an S corporation 100,000 evidenced by a note, and losses reduce debt basis to 40,000. The corporation repays the note in full. What follows?

A. One hundred thousand of ordinary income on the repayment
B. Nothing, since loan repayments are always tax free to a creditor
C. Sixty thousand of capital gain given the written instrument
D. Sixty thousand of ordinary income regardless of documentation

89. A business acquires a 15-year covenant not to compete alongside a business purchase. Over what period is it amortized?

A. The shorter of fifteen years or the covenant's stated term
B. Fifteen years beginning with the month of the acquisition
C. Fifteen years, matching the covenant's stated contractual term
D. Five years, following the ordinary intangible recovery rule

90. A trust has 60,000 of income and distributes 45,000, with the instrument requiring current distribution of all income. What is the trust's deduction?

A. Forty-five thousand, being the amount actually distributed
B. Nothing, since the trust failed to distribute all its income
C. Fifteen thousand, being the undistributed remainder amount
D. Sixty thousand, being the income required to be distributed

91. A business claims 100 percent of a vehicle's cost under Section 179 with ninety percent business use. What is allowed?

A. Ninety percent of the cost subject to the vehicle caps
B. The full cost, since business use exceeds fifty percent
C. Fifty percent of the cost under a proportionate allowance
D. Nothing, because vehicles are excluded from Section 179

92. A partnership incurs 200,000 of syndication costs selling interests to investors. What follows?

A. Deduction of five thousand with the balance amortized
B. Amortization across one hundred eighty months from formation
C. Deduction in full as an ordinary business expense
D. Permanent capitalization with no recovery ever available

93. An exempt organization fails to file its annual return for three consecutive years. When does revocation take effect?

A. On the first day of the fourth consecutive taxable year
B. Only after the organization is given an opportunity to respond
C. On the due date of the third consecutive delinquent return
D. On the date the Service issues a formal notice of revocation

94. A business owner sells a sole proprietorship for a single price covering all its assets. How is gain computed?

A. Asset by asset after allocating the price under the residual method
B. As ordinary income because a proprietorship is not a separate entity
C. As a single capital gain on the sale of the entire business
D. As Section 1231 gain on the aggregate of all the assets sold

95. A business claims a 30,000 deduction and the Service proposes disallowing it as a substantial understatement. What may protect the position?

A. Adequate disclosure where the position has a reasonable basis
B. The taxpayer's clean compliance history in preceding years
C. The fact that a professional preparer signed the return
D. Payment of the disputed amount before assessment is made

96. A corporation with a 31 March year end must file its return by when?

A. The fifteenth day of the fourth month, being 15 July
B. The fifteenth day of the third month, being 15 June
C. The fifteenth day of the sixth month, being 15 September
D. The fifteenth day of the ninth month, being 15 December

97. A business owner contributes a vehicle used personally to a new business. What basis applies for depreciation?

A. The original cost of the vehicle when it was first purchased
B. The fair market value at conversion regardless of original cost
C. The lesser of adjusted basis or fair market value at conversion
D. The adjusted basis without regard to any decline in value

98. A partnership has 40,000 of tax-exempt interest allocated among partners. What is the effect on basis?

A. Outside basis increases by each partner's share of the interest
B. Outside basis is unaffected because the income is not taxable
C. Outside basis decreases by the expenses allocable to the interest
D. Outside basis increases only when the interest is distributed

99. A corporation distributes appreciated property to a shareholder in redemption of shares. What follows?

A. Gain recognized by the corporation as though it had sold it
B. No gain, since a redemption is a capital transaction for both
C. Gain recognized only by the shareholder receiving the property
D. Gain deferred until the shareholder disposes of the property

100. A business owner wishes to withdraw 200,000 from a profitable C corporation with minimum total tax. Which is generally most efficient?

A. A loan repaid over time with market rate interest charged
B. Reasonable compensation deductible by the corporation
C. A redemption of shares receiving exchange treatment
D. A dividend distribution taxed at qualified dividend rates

Practice Exam 30: Answer Key and Explanations

1. C — Insolvency is measured immediately before the discharge, and here assets exceed liabilities by thirty thousand dollars. A solvent taxpayer outside bankruptcy has no insolvency exclusion available, so the entire ninety-five thousand is included unless another exclusion such as qualified real property business indebtedness applies. Qualified real property business indebtedness may still be available.

2. D — Total gain is one hundred ten thousand dollars. Section 751 recharacterizes the portion attributable to unrealized receivables and inventory, being sixty-five thousand, as ordinary income. Only the residual forty-five thousand receives capital gain treatment on the sale of the interest. Section 751 reaches receivables and inventory items alike. Only the residual receives capital gain treatment on the sale.

3. A — Eight percent ownership gives the fifty percent rate and a tentative deduction of seventy-five thousand. The taxable income limitation is fifty percent of one hundred twenty thousand, or sixty thousand, and the lesser controls. The full deduction would not create a loss, so the limitation is not waived. The limitation is waived only where a loss would result.

4. B — Post-2017 losses are capped at eighty percent of taxable income computed without the deduction, giving three hundred twenty thousand. Taxable income falls to eighty thousand and one hundred eighty thousand of the carryforward remains available indefinitely for later years. One hundred eighty thousand remains available indefinitely. Taxable income falls to eighty thousand for the year.

5. C — The deduction cannot exceed aggregate taxable income from the active conduct of any trade or business, so two hundred fifty thousand is allowed. The remaining one hundred fifty thousand carries forward indefinitely and is used in a later year with sufficient income. The carryforward is used in a later year with sufficient income.

6. A — Twenty percent of qualified business income gives thirty-six thousand. The overall cap is twenty percent of taxable income reduced by net capital gain, so twenty percent of one hundred twenty thousand gives twenty-four thousand, and the lesser figure controls the deduction. Net capital gain reduces the base for the overall cap.

7. B — The accumulated earnings credit is two hundred fifty thousand dollars for a general corporation and one hundred fifty thousand for one whose principal function is performing specified services. It operates as a floor below which accumulations are presumptively within reasonable business needs. Service corporations receive the lower of the two figures.

8. D — The safe harbor is ninety percent of the current year tax or one hundred percent of the prior year tax, rising to one hundred ten percent where prior year adjusted gross income exceeded the stated threshold. Higher income taxpayers therefore need the larger figure to be protected. Ninety percent of current year tax remains the alternative.

9. D — Individual installments fall on April fifteenth, June fifteenth, September fifteenth, and January fifteenth of the following year. The pattern differs from the corporate schedule, whose final installment falls in December of the taxable year itself. The corporate final installment falls in December instead. January fifteenth of the following year completes the pattern.

10. B — A guaranteed payment is deductible by the partnership where the underlying expense would be deductible, and it reduces the ordinary income allocated among all the partners. Where the payment relates to a capital expenditure it is capitalized rather than deducted currently. Capital expenditure payments are capitalized rather than deducted. It reduces the ordinary income allocated among all partners.

11. A — Under the nimble dividend rule the two pools are tested separately, so positive current earnings support dividend treatment despite the accumulated deficit. Twenty-five thousand is a dividend and the remaining thirty-five thousand is a return of capital, then capital gain. The deficit does not offset the current earnings at all.

12. C — An S corporation shareholder's distributive share is not self-employment income, and wages bear payroll tax through the ordinary employment tax system rather than self-employment tax. That structural difference is the principal attraction of the S corporation form. Reasonable compensation must nonetheless be paid as wages. Payroll tax reaches the wages through the employment tax system.

13. A — Like-kind exchange treatment no longer reaches personal property, so the trade-in is a taxable sale producing seven thousand of gain, likely recaptured as ordinary income. The new machine takes a full eighty thousand cost basis for depreciation purposes. The gain is likely recaptured as ordinary income on the trade. The new machine takes a full cost basis for depreciation.

14. C — Each category permits five thousand immediately, phased out dollar for dollar above fifty thousand within that category. Organizational costs of eight thousand give the full five thousand, while start-up costs of sixty-two thousand exceed the threshold by twelve thousand and give nothing. The two categories are tested entirely separately from each other.

15. B — Three thousand of organizational costs and sixty-two thousand of start-up costs, being sixty-five thousand in total, are amortized over one hundred eighty months beginning with the month active business commences. The two categories are tracked separately despite sharing that period. Amortization begins with the month active business commences. The two categories are tracked separately despite sharing it.

16. D — Undistributed income is taxed to the trust at rates reaching the top bracket at a very low income level. That compression is the principal reason fiduciaries distribute income to beneficiaries where the instrument permits and the beneficiaries face lower rates. Fiduciary brackets reach the top rate at very low income.

17. B — Self-created goodwill sold as part of a business produces capital gain where the required holding period is met. Purchased goodwill that was amortized would instead face Section 1245 recapture to the extent of the amortization actually claimed on it. Purchased and amortized goodwill would face recapture instead. The required holding period must nonetheless be satisfied.

18. A — Adjusted basis is sixty thousand, giving forty thousand of gain. Section 1245 recaptures the thirty thousand of amortization as ordinary income, and only the residual ten thousand receives Section 1231 or capital treatment on the disposition. Only the residual receives Section 1231 or capital treatment. Adjusted basis of sixty thousand produces the forty thousand gain.

19. D — The cap is business interest income of five thousand plus thirty percent of ninety thousand, giving thirty-two thousand. Interest expense of forty thousand exceeds that, so thirty-two thousand is deductible and eight thousand carries forward indefinitely. Eight thousand carries forward indefinitely to later years. Thirty percent of adjusted taxable income sets the main limb.

20. C — A taxpayer meeting the same gross receipts test that governs accrual accounting, inventory, and capitalization is exempt from the business interest limitation entirely. Real property and farming businesses may also elect out at the cost of using the alternative depreciation system. Real property and farming businesses may also elect out.

21. B — Depreciation begins when property is placed in service and ready for its intended use, not when it is acquired or paid for. Bonus depreciation percentage by contrast is determined by the acquisition date, so the two dates can point to different years. Bonus percentage is fixed by acquisition date instead.

22. C — A cash method taxpayer deducts on delivery or mailing provided the check is honoured in due course and funds were available. Postdating defers the deduction, and the rule mirrors constructive receipt on the income side of the ledger. Postdating the check defers the deduction accordingly. Funds must have been available when the check was delivered.

23. D — Basis caps the loss at forty-five thousand and the at-risk figure imposes no further limit. The passive activity rules then cap it at the twenty thousand of passive income, so fifteen thousand is suspended by basis and twenty-five thousand by the passive rules. Twenty-five thousand is suspended by the passive rules.

24. A — A sole shareholder's proportionate interest remains one hundred percent after any redemption, so no redemption test can be satisfied. The distribution is therefore an ordinary dividend to the extent of earnings and profits regardless of how many shares were surrendered. No redemption test can be satisfied by a sole shareholder.

25. A — Ownership above fifty percent makes the parties related, so the loss is disallowed entirely. The disallowed amount may reduce the purchaser's gain on a later resale to an outsider, meaning the economic benefit shifts to the buyer rather than being lost to everyone. The economic benefit shifts to the buyer rather than vanishing.

26. D — A simple trust must distribute all income currently, make no charitable contributions, and distribute no corpus during the year. Meeting all three conditions gives simple trust status, and the classification is tested annually rather than fixed when the trust is created. Classification is tested annually rather than fixed at creation.

27. C — A regularly conducted retail operation staffed by paid workers meets the three elements and no exception applies. The volunteer exception requires substantially all work to be uncompensated, and using proceeds for the exempt purpose never establishes substantial relation. Using proceeds for exempt purposes never establishes relation. Substantially all work must be uncompensated for that exception.

28. B — The elected forty thousand is notionally spread across the three base years and taxed using whatever bracket capacity those years left unused. The earlier returns are unaffected and are not amended, since they serve only as a computational reference. The base year returns are unaffected and are not amended. They serve only as a computational reference for the election.

29. A — Exceeding the gross receipts threshold engages the accrual method mandate, the inventory requirement, and the uniform capitalization rules simultaneously. Each is a change in accounting method producing its own Section 481 adjustment spread across four years. Each change produces its own Section 481 adjustment. A positive adjustment spreads across four taxable years.

30. B — Liabilities assumed of ninety thousand exceed the eighty thousand basis of the transferred property by ten thousand, and that excess is recognized as gain under Section 357(c). Cash contributed alongside does not shelter the excess, which is a frequently missed point. Cash contributed alongside does not shelter that excess. Section 357(c) recognizes only the excess over that basis.

31. C — Inventory distributed by a partnership retains its ordinary character in the partner's hands for five years following the distribution. Selling within that period therefore produces ordinary income regardless of how the partner actually held the property. The character follows the property rather than the holder. Five years must elapse before the character finally changes.

32. D — Under the tax benefit rule the recovery is income to the extent the earlier deduction reduced tax. Where the loss produced no benefit, because of a loss year for example, the recovery is excluded to that extent rather than being taxed in full. No benefit means no income under the tax benefit rule.

33. C — Passive investment income of thirty percent exceeds the twenty-five percent threshold, so the tax on excess net passive income applies. Termination follows only after three consecutive years above the threshold with accumulated earnings still present. Three consecutive years above the threshold would terminate it. Accumulated earnings must also still be present for that.

34. B — The two and a half month rule is unavailable where the recipient is a related party. The matching rule defers the deduction until the cash method recipient includes the amount, so a March payment gives a deduction in the later year. A March payment therefore gives a deduction in the later year.

35. A — A profits interest carrying no right to existing partnership capital is generally not taxable on receipt where the published conditions are met. A capital interest received for services is by contrast immediately taxable at the fair market value received. A capital interest for services is immediately taxable instead. Published conditions must be met for the safe harbor to apply.

36. D — A governmental contribution to capital of a corporation is generally excluded from income, but the basis of property acquired with the funds is reduced correspondingly. The benefit is therefore a deferral through reduced depreciation rather than a permanent exclusion. Reduced depreciation defers rather than eliminates the benefit. Corporate contributions to capital are generally excluded.

37. A — Aggregation requires the same person or group owning a majority of each, the businesses sharing significant centralized elements or operating in coordination, and none being a specified service trade or business. An annual disclosure statement must accompany the return. An annual disclosure statement must accompany the return. None of the businesses may be a specified service business.

38. B — Losses reduce stock basis first and then debt basis, absorbing fifty thousand in total. The remaining fifteen thousand is suspended indefinitely and becomes deductible only when basis is restored by contributions, further loans, or allocated income. Contributions, loans, or income restore the basis later. Stock basis absorbs the loss before debt basis is reduced.

39. D — The limitation is ten percent of taxable income computed before the charitable and dividends received deductions, giving four thousand. The remaining eighty-six thousand carries forward five years, and gross receipts play no part in the computation. Gross receipts play no part in the computation at all. Eighty-six thousand carries forward for five taxable years.

40. C — Where a liquidating distribution consists only of money, unrealized receivables, and inventory, loss may be recognized to the extent basis exceeds the amounts received. Cash alone qualifies, so twenty-five thousand of capital loss is recognized here. Cash alone satisfies the composition requirement here. Loss arises only where basis exceeds the amounts received.

41. A — Business use is eight thousand of twelve thousand total miles, giving two thirds. The taxpayer may instead use the standard mileage rate applied to the business miles, but must generally choose that method in the vehicle's first business year. The mileage method must generally be chosen in the first year.

42. D — A qualified sponsorship payment carries no substantial return benefit beyond acknowledgment, which may include the sponsor's name and logo. Qualitative comparisons, price information, endorsements, or payments contingent on attendance would convert it into taxable advertising revenue instead. Contingent payments would convert it into advertising revenue. Name and logo acknowledgment remains within the safe harbor.

43. B — Adjusted basis is thirty-five thousand and gain is thirty-five thousand. Section 1245 recaptures the twenty-five thousand of depreciation as ordinary income, leaving ten thousand for Section 1231 treatment provided the holding period is met. The holding period must still be satisfied for that treatment. Section 1245 applies because the animals were depreciated.

44. C — Client meals are fifty percent deductible where the taxpayer or an employee is present, giving seven thousand five hundred. Office snacks are also subject to the fifty percent limitation, giving three thousand, for a combined ten thousand five hundred. Office snacks now fall within the same fifty percent limit. The taxpayer or an employee must be present at the meals.

45. D — Federal income tax reduced book income and is added back, while exempt interest is book income that never becomes taxable and is subtracted. Two hundred fifty thousand plus forty-five thousand less thirty thousand gives two hundred sixty-five thousand. Both reconciling items move in opposite directions. Exempt interest never becomes taxable in any circumstance.

46. C — Bonus depreciation carries no taxable income limitation and may create or increase a net operating loss. Section 179 by contrast cannot exceed aggregate business taxable income, which is the principal structural difference between the two provisions. Section 179 cannot exceed aggregate business taxable income. A net operating loss may therefore be created or increased.

47. B — A constructive liquidation identifies who bears the economic burden, and a limited partner generally bears none for a recourse liability. The general partner is therefore allocated the entire amount, which is why limited partners rely on nonrecourse debt for basis. Limited partners rely on nonrecourse debt for their basis. A general partner bears the entire economic burden here.

48. A — An S corporation recognizes gain but never loss on distributing property, exactly as a C corporation does. Distributing depreciated property therefore destroys the loss entirely, so selling the property and distributing cash preserves it instead. Selling and distributing cash would preserve the loss instead. Gain but never loss arises on distributing appreciated property.

49. A — Genuine documentation, a market rate of interest, a fixed maturity, and actual repayment support treating the advance as a bona fide loan. The corporation reports interest income and the shareholder may deduct the interest depending on the use of the proceeds. Interest deductibility depends on the use of the proceeds.

50. C — Expenses directly allocable to tax-exempt income are wholly disallowed, so the entire five thousand is lost where it is genuinely traceable to the exempt interest. Indirect expenses are separately allocated by the proportion exempt income bears to total income. Indirect expenses are separately allocated by proportion. Direct traceability to the exempt income is what matters.

51. D — Qualified improvement property carries a fifteen-year period and is eligible for both Section 179 expensing and bonus depreciation. It covers interior improvements to nonresidential real property made after the building was first placed in service by any taxpayer. It covers interior improvements made after the building was first placed in service by any taxpayer.

52. B — Enlargements, elevators and escalators, and the internal structural framework are all expressly excluded. Interior work such as partitions, electrical improvements, and lighting qualifies provided it was carried out after the building was first placed in service. Interior partitions, electrical work, and lighting all qualify where the timing condition is satisfied.

53. A — Debt-financed income enters unrelated business taxable income in proportion to the average acquisition indebtedness, giving thirty-two thousand here. The character flows through the partnership to the exempt partner rather than being sheltered by the partnership form. The character flows through the partnership rather than being sheltered by the partnership form itself.

54. D — Where the closely held stock exceeds the required share of the adjusted gross estate, a redemption up to death taxes plus funeral and administration expenses receives exchange treatment. With a stepped-up basis the resulting gain is usually minimal. With a stepped-up basis at death the resulting gain on the redemption is usually minimal for the estate.

55. C — Six hundred hours satisfies the five hundred hour test for the first activity. The second satisfies the separate test requiring more than one hundred hours where no other individual participates more, so both are materially participated in independently. Both activities are therefore materially participated in independently of one another for the year.

56. B — Excessive compensation in a C corporation is recharacterized as a dividend, nondeductible by the corporation while remaining fully taxable to the shareholder. The independent investor test asks whether a hypothetical investor would find the remaining return acceptable. The independent investor test asks whether a hypothetical investor would find the remaining return acceptable.

57. D — Where a partner transacts in a capacity other than as a partner, the payment is treated as made to an outsider. The partnership deducts or capitalizes it accordingly and the partner reports it independently of the partnership's own results. The partnership deducts or capitalizes it and the partner reports it independently of partnership results.

58. C — The credit is limited by net income tax reduced by the greater of tentative minimum tax or a percentage of regular tax above a threshold. The unused amount carries back one year and forward twenty, so nothing is lost immediately. The unused amount carries back one year and forward twenty, so nothing is lost immediately at all.

59. B — The farmer must establish that the weather condition caused a sale of more animals than would normally have been sold. Designation as a disaster area assists but is not itself required, and the deferral election is available only to cash method farmers. Disaster area designation assists but is not required, and only cash method farmers may elect it.

60. A — The enhanced deduction is the lesser of basis plus half the appreciation, or twice basis. Basis plus half of twenty-five thousand gives twenty-seven thousand five hundred, while twice basis gives thirty thousand, so the smaller figure controls. The property must be used for the care of the ill, needy, or infants for the enhanced amount.

61. D — A trust deducts capital losses against capital gains plus three thousand dollars of ordinary income, exactly as an individual does. The remaining twenty-seven thousand carries forward and passes to the beneficiaries in the trust's final taxable year. The remaining twenty-seven thousand carries forward and passes to beneficiaries in the final year.

62. C — Income and deductions are computed separately for each unrelated business, so the loss cannot offset the other activity's income. Six thousand is reduced by the one thousand dollar specific deduction to five thousand, with the loss carried forward within its own activity. The loss is carried forward within its own activity against that activity's future income only.

63. B — Income increases basis before distributions reduce it, so basis rises to forty thousand and the thirty-five thousand distribution is tax free, leaving five thousand of basis. The ordering matters greatly where basis begins the year at zero. Income increases basis before distributions reduce it, which matters where basis begins at zero.

64. D — A Section 743 adjustment of sixty thousand belongs to that transferee alone where a Section 754 election is in place. Without the election the disparity persists, unless a substantial built-in loss makes the adjustment mandatory in any event. Without the election the disparity persists unless a substantial built-in loss makes it mandatory.

65. A — A covenant not to compete produces ordinary income to the recipient in the year received under the recipient's method, while the payer amortizes it over fifteen years. That asymmetry makes the allocation between goodwill and covenant a genuine negotiating point. That asymmetry makes allocation between goodwill and covenant a genuine negotiating point for the parties.

66. B — Reasonable compensation measures the value of services rendered, not a proportion of profits. Where much of the income derives from capital rather than the owner's labour, a lower salary relative to income is more readily defended than in a service business. Where income derives largely from capital rather than labour, a lower salary is more readily defended.

67. A — A transfer of money followed by a related distribution within two years is presumed to be a disguised sale unless the facts establish otherwise. The presumption is rebuttable, but the timing of the two steps drives most of the analysis. The presumption is rebuttable, but the timing of the two steps drives most of the analysis.

68. C — Interest allocable to the production period of self-constructed property must be capitalized into the property's basis and recovered through depreciation across its recovery period. Direct materials, direct labour, and allocable indirect costs are capitalized on the same footing. Direct materials, direct labour, and allocable indirect costs are capitalized on the same footing.

69. B — The sixty-five day election treats such a distribution as made on the last day of the preceding year, permitting income to be shifted to beneficiaries after the year's results are known. Compressed fiduciary brackets usually make the shift worthwhile. Compressed fiduciary brackets usually make shifting income to beneficiaries genuinely worthwhile.

70. A — The test uses the three-year average rather than the current year alone, so a modest current year does not help. Exceeding the threshold engages the accrual mandate, inventory accounting, and the capitalization rules together. Exceeding it engages the accrual mandate, inventory accounting, and the capitalization rules together. A modest current year does not help where the average is high.

71. C — Section 530 relief requires reasonable basis, substantive consistency, and reporting consistency, all holding simultaneously. Where they do, the employer escapes reclassification liability entirely, while Section 3509 reduced rates apply where relief is unavailable. Section 3509 reduced rates apply instead where the three conditions are not all satisfied. All three conditions must hold simultaneously for the relief.

72. D — Specific, definite, and feasible plans for expansion, debt retirement, or working capital support reasonable business needs. Vague intentions do not, and the burden shifts depending on whether the Service has issued a notification to the corporation. Vague intentions do not suffice, and the burden shifts once the Service issues a notification.

73. A — The allocation must have substantial economic effect, requiring capital accounts maintained under the regulations, liquidation by positive balances, and a deficit restoration obligation or qualified income offset. Failing that it is reallocated by the partners' interests. Failing those conditions means the allocation is reallocated according to the partners' interests. Capital accounts must be maintained under the prescribed rules.

74. B — Depreciation recapture is recognized in full in the year of sale even where little or no cash is received. Only the twenty thousand of remaining gain is spread across the installment payments as they are collected from the buyer. Only the remaining twenty thousand spreads across the installment payments as they are collected.

75. D — The election requires gross receipts below the stated threshold for the current year and no gross receipts more than five years before it. The credit is then applied against employer payroll taxes up to an annual cap rather than income tax. The credit applies against employer payroll taxes up to an annual cap rather than income tax.

76. C — Nonrecourse deductions are allocated consistently with some significant partnership item and are supported by a minimum gain chargeback, which allocates income back to those partners when partnership minimum gain later decreases. A minimum gain chargeback allocates income back to those partners when minimum gain later decreases. They must be allocated consistently with a significant item.

77. C — The simplified method applies the published rate to a maximum of three hundred square feet however large the office is. No depreciation is claimed, basis is unreduced, and no carryforward of amounts exceeding the income limitation is permitted. No depreciation is claimed, basis is unreduced, and no carryforward of excess amounts is permitted.

78. D — The corporation recognizes five hundred thousand as if it sold the assets at fair market value, and the shareholder recognizes six hundred fifty thousand on the deemed sale of the stock. That two-layer result is why liquidating an appreciated C corporation is so costly. That two-layer result is why liquidating an appreciated C corporation is so costly in practice.

79. B — Electing out permits deducting preproductive period costs but requires using the alternative depreciation system for all farming property placed in service in any year the election is in effect, which means longer lives and straight line recovery. Longer lives and straight line recovery are the price of deducting those costs currently.

80. A — Related transactions are aggregated, so forty thousand across a fortnight requires reporting within fifteen days of the payment that crosses the ten thousand threshold. Structuring receipts to stay below it is a separate criminal offence. Structuring receipts to stay below the threshold is itself a separate criminal offence entirely. Fifteen days runs from the payment that crosses the threshold.

81. D — The eighty thousand excess is an excess benefit transaction attracting excise tax on the disqualified person, a further tax if not corrected, and a separate tax on managers who knowingly approved it. Board approval alone provides no protection. Board approval alone provides no protection without comparability data and adequate documentation.

82. A — A Section 743 adjustment applies to transfers by death as well as by sale, so the successor's share of inside basis is adjusted to match the stepped-up outside basis. Without the election the two figures remain permanently mismatched. Without the election the outside and inside basis figures remain permanently mismatched.

83. B — The credit is limited to the United States tax attributable to foreign source income, computed by the ratio of foreign source income to total taxable income. Excess amounts carry back one year and forward ten within the applicable category. Excess amounts carry back one year and forward ten within the applicable income category.

84. C — A negative adjustment decreasing income is taken entirely in the year of change, while a positive adjustment increasing income spreads across four years. Applying the four-year spread symmetrically is a common and consequential error. Applying the four-year spread symmetrically is a common and genuinely consequential error. Positive adjustments increasing income spread across four years.

85. D — An S corporation partner counts by reference to the statements it must furnish its own shareholders, so eighty plus forty gives one hundred twenty. That exceeds the limit, defeating the election even though the direct partner count is modest. That exceeds the limit, defeating the election even though the direct partner count is modest.

86. B — Average customer use of seven days or less means the activity is not a rental activity at all, so it is tested under ordinary material participation standards. A materially participating short-term lodging operator may therefore deduct losses in full. A materially participating short-term lodging operator may therefore deduct losses in full.

87. A — Political contributions, campaign expenditures, and lobbying to influence federal or state legislation are all nondeductible. Local legislation lobbying and ordinary monitoring of legislative developments generally escape the disallowance entirely. Local legislation lobbying and monitoring of developments generally escape the disallowance. Campaign expenditures and federal lobbying are equally disallowed. No business purpose can rescue such a payment.

88. C — Repayment exceeding remaining debt basis produces income of sixty thousand. Where the debt is evidenced by a written instrument the income is capital gain; an open account advance would produce ordinary income instead. An open account advance would produce ordinary income rather than capital gain instead. Remaining debt basis of forty thousand is recovered tax free.

89. C — All Section 197 intangibles are amortized ratably over fifteen years from the month of acquisition regardless of actual or contractual life. The coincidence of the term and the period here does not change the governing rule at all. The coincidence of the term and the period here does not change the governing rule at all.

90. D — A simple trust deducts the income required to be distributed currently whether or not it was actually paid, so the deduction is sixty thousand and the beneficiary reports that amount. The trustee's failure to pay does not defer the beneficiary's tax. The trustee's failure actually to pay does not defer the beneficiary's tax on the amount.

91. B — Only the business use portion is eligible, so ninety percent of the cost enters the computation, and passenger automobile caps then limit the amount unless the vehicle is a qualifying heavy or nonpersonal use vehicle. Passenger automobile caps then limit the amount unless it is a qualifying heavy vehicle. Only the business use portion enters the computation at all.

92. A — Syndication costs including commissions, registration fees, and printing of offering materials are capitalized permanently with neither deduction nor amortization available. Genuine organizational costs by contrast qualify for the immediate deduction and amortization treatment. Genuine organizational costs by contrast qualify for deduction and amortization treatment. Commissions, registration fees, and offering materials are covered.

93. D — Revocation is automatic by operation of law effective from the due date of the third delinquent return, with no notice required. Reinstatement requires a fresh application and fee, and retroactive reinstatement demands reasonable cause and all delinquent returns. Reinstatement requires a fresh application, and retroactive relief demands reasonable cause. No notice is required before the revocation takes effect.

94. C — A proprietorship sale is a sale of the individual assets, with the price allocated across the seven classes under the residual method. Each asset then produces its own character, so recapture, ordinary income, and capital gain frequently arise together. Recapture, ordinary income, and capital gain therefore frequently arise together on one sale.

95. A — Adequate disclosure protects against the substantial understatement penalty where the position has a reasonable basis, which is more than not frivolous. Reasonable cause and good faith remains a separate and broader defence to the penalty. Reasonable cause and good faith remains a separate and broader defence to the same penalty.

96. B — A C corporation files by the fifteenth day of the fourth month after the year end, giving July fifteenth for a March year end. Partnerships and S corporations file a month earlier so owners receive their statements first. Partnerships and S corporations file a month earlier so owners receive statements first.

97. C — The depreciable basis on converting personal property to business use is the lesser of adjusted basis or fair market value at conversion, which prevents a personal decline in value becoming a business deduction. The same figure governs any later loss computation. The same lower figure governs any loss computed on a later sale of the property.

98. A — Tax-exempt income increases outside basis even though it is never taxed, preserving the exemption on eventual disposition of the interest. Nondeductible noncapital expenses form the exact mirror image, reducing basis despite producing no deduction. Nondeductible noncapital expenses form the exact mirror image on the reducing side. The exemption is preserved on eventual disposal of the interest.

99. B — A corporation recognizes gain on distributing appreciated property whether the distribution is ordinary or in redemption. The shareholder separately determines whether the redemption receives exchange or dividend treatment under the applicable tests. The shareholder separately determines exchange or dividend treatment under the tests. Gain arises whether the distribution is ordinary or in redemption.

100. D — Reasonable compensation is deductible by the corporation and taxed once to the recipient, whereas a dividend bears tax at both levels. Payroll tax reduces but does not eliminate the advantage, and the amount must genuinely reflect services rendered. Payroll tax reduces but does not eliminate the advantage over a dividend distribution.