PRACTICE EXAM 7: 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. Which entity classification applies to a foreign eligible entity with one member having unlimited liability?

A. An association taxable as a corporation by default rule
B. Disregarded as an entity separate from its single owner
C. A partnership, following the domestic multi-member default
D. A foreign trust governed by the grantor trust provisions

2. What is the effective date range available on a Form 8832 classification election?

A. The first day of the year the election is actually filed
B. Any date within the five years following the filing date
C. Up to twelve months before or seventy-five days after filing
D. Up to seventy-five days before or twelve months after filing

3. Which condition permits an earlier classification change despite the sixty-month limitation?

A. Unanimous written consent of all members of the entity
B. A change in the entity's principal place of business
C. More than half the ownership held by persons not previously owners

D. Payment of a user fee accompanying the new election form

4. Which entity must obtain a new employer identification number after a change?

A. A sole proprietorship that incorporates under state law
B. A corporation that changes its registered trade name
C. A partnership that admits three additional partners
D. A business that opens two additional retail locations

5. Which tax year must a personal service corporation generally use?

A. Any fiscal year ending within twelve months of formation
B. A calendar year absent an established business purpose
C. The tax year used by its principal owner-employees
D. The year producing the least aggregate deferral of income

6. How is a hobby determination affected by filing Form 5213?

A. The activity is conclusively treated as engaged for profit
B. The nine-factor analysis is permanently waived by the Service
C. The taxpayer must establish profit within the following year
D. The determination is postponed until the presumption period ends

7. Which item of business income is fully taxable despite its source?

A. Proceeds derived from an illegal business activity
B. Amounts received as a gift from a business associate
C. Loan proceeds deposited into the business account
D. Capital contributed by an owner during the year

8. Which contribution to a partnership starts a new holding period in the interest received?

A. Land held for investment for several years by the partner
B. Equipment used in the partner's separate trade or business
C. Cash contributed on the formation of the partnership
D. A building held for the production of rental income

9. Which allocation must a partnership make regardless of its agreement?

A. An equal allocation of ordinary income among all partners
B. An allocation of precontribution gain to the contributing partner
C. An allocation of losses in proportion to capital accounts
D. An allocation of credits by reference to capital contributed

10. Which event reduces a partner's outside basis without being a loss?

A. An allocation of tax-exempt interest income for the year
B. An increase in the partner's share of partnership liabilities
C. A capital contribution made during the taxable year
D. A decrease in the partner's share of partnership liabilities

11. Which distribution triggers gain to a partner?

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

12. Which item is included in the amount realized on the sale of a partnership interest?

A. The seller's share of partnership liabilities assumed by the buyer
B. The seller's capital account balance at the start of the year
C. The partnership's inside basis in its underlying assets
D. The buyer's projected share of future partnership profits

13. What is required for a partnership's Section 754 election to bind future transfers?

A. Nothing further; it applies until revoked with permission
B. An annual renewal filed with each subsequent return
C. The consent of each transferee partner as they are admitted
D. A separate election for every individual transfer occurring

14. Which statement about the partnership representative is correct?

A. The representative must hold a majority partnership interest
B. Each partner may appoint a separate representative annually
C. The representative must be a natural person in every case
D. The representative need not be a partner in the partnership

15. Which amount does a partnership pay where it does not make a push-out election?

A. The aggregate additional tax computed on each partner's return
B. A fixed penalty determined by the number of partners involved
C. An imputed underpayment computed at the highest applicable rate
D. Nothing, because partnerships never pay entity-level tax

16. Which requirement applies to the control test under Section 351?

A. Eighty percent of the total value of all outstanding stock
B. Eighty percent of voting power and of each nonvoting class
C. Fifty-one percent of the total combined voting power only

D. One hundred percent ownership by the transferring group

17. What happens where a shareholder is contractually bound to sell shares to an outsider immediately after a Section 351 exchange?

A. Those shares are generally excluded from the control computation
B. The transaction qualifies because control existed momentarily
C. The corporation recognizes gain on the property received
D. The prearranged sale is disregarded for all tax purposes

18. Which liability treatment applies on a Section 351 transfer with a bona fide business purpose?

A. The full liability is treated as boot received by the shareholder
B. The liability increases the shareholder's basis in the stock
C. The liability is disregarded in every basis computation
D. The liability reduces stock basis and is generally not boot

19. Which corporation may not make an S election?

A. A domestic corporation with ninety-five individual shareholders
B. A corporation with voting and nonvoting common stock
C. An insurance company taxed under the special insurance provisions
D. A corporation owning a wholly owned domestic subsidiary

20. Which action does an S corporation take to treat a wholly owned subsidiary as disregarded?

A. It elects qualified subchapter S subsidiary treatment
B. It files a consolidated return including the subsidiary
C. It liquidates the subsidiary into the parent corporation
D. It distributes the subsidiary's stock to its shareholders

21. Which item increases an S corporation shareholder's stock basis?

A. A distribution received during the taxable year in cash
B. The shareholder's share of tax-exempt income for the year
C. Nondeductible noncapital expenses allocated on the K-1
D. Separately stated deductions passed through to the shareholder

22. Which statement about restoration of an S corporation shareholder's basis is correct?

A. Stock basis is restored before any debt basis is rebuilt
B. Both are restored proportionately to their prior reductions
C. Debt basis is restored first, up to the amount reduced
D. Neither is restored once reduced in a prior taxable year

23. Which event terminates an S election on the date it occurs?

A. A revocation filed after the fifteenth day of the third month
B. A transfer of one share to an ineligible shareholder
C. The corporation's failure to file a timely annual return
D. A distribution exceeding the accumulated adjustments account

24. How many years must generally pass before a corporation may reelect S status after termination?

A. One taxable year following the year of termination
B. Three taxable years following the year of termination
C. There is no waiting period where shareholders consent
D. Five taxable years, absent the Service's consent

25. Which item is a separately stated item for an S corporation?

A. Depreciation on machinery used in ordinary operations
B. Charitable contributions made during the taxable year
C. Rent paid for the corporation's business premises
D. Utilities consumed at the operating location

26. Which condition must a corporation satisfy to deduct a bonus accrued to an unrelated employee?

A. Payment must occur before the close of the accrual year
B. The employee must consent to the accrual in writing
C. Payment must occur within two and a half months after year end
D. The bonus must not exceed the employee's regular annual salary

27. How is an S corporation shareholder's health insurance premium reported?

A. Excluded from wages entirely as a fringe benefit provided
B. Deducted by the shareholder only, with no corporate deduction
C. Reported on Form 1099 rather than the Form W-2 wages
D. Included in Box 1 wages and deducted by the corporation

28. Which item is aggregated into ordinary business income rather than separately stated?

A. Repairs to the entity's operating premises during the year
B. Section 179 expense elected on qualifying equipment
C. Foreign taxes paid or accrued during the taxable year
D. Capital gains recognized on investment securities sold

29. Which figure limits an owner's deduction of an entity loss first?

A. The passive activity limitation on nonparticipating owners
B. The owner's basis in the entity interest held
C. The at-risk amount excluding nonrecourse financing

D. The annual excess business loss limitation cap

30. Which method of accounting must a tax shelter use?

A. The cash method, regardless of gross receipts levels
B. A hybrid method combining cash and accrual elements
C. The completed contract method for all long-term work
D. The accrual method, regardless of gross receipts levels

31. Which inventory valuation method may be combined with lower of cost or market?

A. First-in, first-out valuation of inventory items held
B. Last-in, first-out valuation of inventory items held
C. The dollar-value last-in, first-out pooling method
D. Any method the taxpayer elects on a timely return

32. Which cost must a reseller capitalize under the uniform capitalization rules?

A. Advertising promoting the merchandise held for resale
B. Selling commissions paid on completed customer sales
C. Purchasing department costs allocable to acquisitions
D. Delivery of sold goods to the purchasing customers

33. Which amount is excluded from a taxpayer's amount at risk?

A. Cash contributed directly to the activity by the taxpayer
B. The adjusted basis of property contributed to the activity
C. Borrowed amounts for which the taxpayer is personally liable
D. Amounts protected by a stop-loss or similar arrangement

34. How is recourse debt satisfied in foreclosure analysed where property value is below the debt?

A. Entirely as cancellation of indebtedness income to the debtor
B. Entirely as gain or loss on the disposition of property
C. Bifurcated into disposition gain or loss plus cancellation income
D. As a nontaxable event deferred until a later resale occurs

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

A. The basis of depreciable property held by the taxpayer
B. Net operating loss carryovers available to the taxpayer
C. Foreign tax credit carryovers from earlier taxable years
D. Passive activity loss and credit carryovers accumulated

36. Which compensation risk arises in a closely held C corporation?

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

37. Which family employment arrangement is exempt from Social Security and Medicare tax?

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

38. Which arrangement between an owner and a business is respected where the terms are reasonable?

A. A lease where rent varies with the entity's annual profits
B. A lease of owner-held property at market rent to the business
C. A loan lacking any documented maturity or interest rate
D. Compensation substantially exceeding comparable industry rates

39. Which expense remains fully deductible under current law?

A. Club dues paid for an employee's recreational membership
B. Tickets purchased for a client to attend a sporting event
C. Meals sold to customers in the ordinary course of business
D. A bundled invoice covering both entertainment and food

40. Which requirement applies to a self-employed taxpayer using per diem rates?

A. Actual lodging cost must be substantiated separately
B. Both meal and lodging portions may be claimed at published rates
C. The high-low method must be used for all business travel
D. No substantiation of time or place is required at all

41. Which vehicle rule bars future use of the standard mileage rate?

A. Using the vehicle for more than fifteen thousand miles annually
B. Claiming actual expenses in the second year of business use
C. Claiming Section 179 or accelerated depreciation on the vehicle
D. Leasing rather than purchasing the vehicle outright

42. Which interest is deductible as business interest?

A. Interest on a loan secured by business assets used personally
B. Interest on a residence-secured loan used to fund operations
C. Interest prepaid for the three following taxable years

D. Interest on amounts borrowed to purchase municipal bonds

43. Which item requires capitalization under the improvement standard?

A. Restoration of a building to like-new condition after its class life
B. Cleaning and patching of a worn interior floor surface
C. Replacement of individual worn parts in operating machinery
D. Routine repainting of an office suite between tenancies

44. Which safe harbor requires a written accounting policy at the start of the year?

A. The routine maintenance safe harbor for building systems
B. The small taxpayer safe harbor for building expenditures
C. The partial disposition election for replaced components
D. The de minimis safe harbor for tangible property costs

45. Which item is depreciated over fifteen years?

A. Office furniture with no designated class life assigned
B. A commercial building housing the taxpayer's operations
C. Computer equipment and associated peripheral devices
D. Qualified improvement property to a nonresidential building

46. How is gain characterized on the sale of depreciable personal property at a profit?

A. Entirely as Section 1231 gain subject to the netting rules
B. Entirely as ordinary income regardless of the amount
C. Ordinary to the extent of depreciation, then Section 1231
D. As capital gain reduced by unrecaptured depreciation

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

A. Real property held for productive use in a business
B. Equipment traded in on a replacement machine purchase
C. A partnership interest exchanged for another such interest
D. Livestock exchanged for animals of the same species

48. Which deadline governs identification of replacement property in a deferred exchange?

A. One hundred eighty days from the transfer of relinquished property
B. Forty-five days from the transfer of relinquished property
C. The due date of the return including any extensions filed
D. Ninety days from the closing of the relinquished property sale

49. Which item is excluded from qualified business income?

A. Ordinary income from a domestic manufacturing partnership
B. Rental income from a domestic trade or business activity
C. Section 1231 gain treated as ordinary loss for the year
D. Capital gains recognized on the sale of business securities

50. What is the effect where taxable income falls below the qualified business income threshold?

A. The deduction is denied entirely for service businesses
B. The wage and property limitation applies at half strength
C. No wage limitation and no service business disallowance apply
D. Only half of qualified business income counts toward it

51. Which business is not a specified service trade or business?

A. An architecture practice designing commercial buildings
B. A financial services firm advising investment clients
C. A performing arts company staging theatrical productions
D. An actuarial consultancy serving insurance carriers

52. Which limb of the wage and property limitation uses unadjusted basis?

A. Fifty percent of W-2 wages paid by the qualified business
B. Twenty percent of qualified business income for the year
C. One hundred percent of the taxable income ceiling amount
D. Twenty-five percent of wages plus a percentage of property

53. How is a net qualified business loss treated?

A. It produces a current deduction against nonbusiness income
B. It reduces the following year's qualified business income
C. It converts into a capital loss carryover for the taxpayer
D. It is permanently disallowed at the close of the loss year

54. Which carryover period applies to unused general business credits?

A. Two years back and twenty years forward from the credit year
B. One year back and twenty years forward from the credit year
C. Three years back and five years forward from the credit year
D. No carryback, with an indefinite carryforward permitted

55. Which figure limits a post-2017 net operating loss deduction?

A. Eighty percent of taxable income before the loss deduction
B. Fifty percent of adjusted gross income for the carryover year
C. One hundred percent of taxable income without any limitation

D. The amount of business income reported for that same year

56. Which item is a permanent difference on the book-tax reconciliation?

A. An allowance for doubtful accounts recorded on the books
B. Warranty reserves accrued for financial reporting purposes
C. Life insurance proceeds received on a key employee policy
D. Accelerated depreciation exceeding the book depreciation

57. How is a positive Section 481(a) adjustment taken into account?

A. Entirely in the taxable year the method change occurs
B. Ratably over four years beginning with the change year
C. Over the remaining useful life of the affected property
D. Only upon disposition of the property giving rise to it

58. Which entity files Schedule M-3 in place of Schedule M-1?

A. Any corporation using the accrual method of accounting
B. Any partnership with more than one hundred partners
C. Any corporation with gross receipts above five million dollars
D. An entity with total assets of ten million dollars or more

59. Which technique reveals receipts omitted from a business income statement?

A. Comparing business-source deposits against reported receipts
B. Verifying that the balance sheet totals foot correctly
C. Reconciling depreciation to the fixed asset ledger detail
D. Confirming that retained earnings ties to prior year figures

60. Which factor indicates financial control supporting independent contractor status?

A. Detailed instructions about when and how work is performed
B. Training provided by the business in preferred procedures
C. A significant unreimbursed investment by the worker
D. Provision of employee-type benefits to the worker

61. Which condition must all be met for statutory relief from worker reclassification liability?

A. Prior examination, professional advice, and small business status
B. A written contract, worker consent, and industry practice
C. Reasonable basis, substantive consistency, and reporting consistency
D. Voluntary disclosure, back payment, and prospective correction

62. Which deposit obligation arises where accumulated employment tax liability reaches one hundred thousand dollars?

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

63. Who may be assessed the trust fund recovery penalty?

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

64. How long must records supporting the basis of business property be kept?

A. Three years from the date the property was first acquired
B. Four years after the property becomes fully depreciated
C. Six years from the date the property was placed in service
D. Until the limitations period expires for the disposition year

65. Which expense category may not be substantiated by reasonable estimate?

A. Utilities consumed at a business operating location
B. Ordinary office supplies purchased during the year
C. Travel, meals, gifts, and listed property expenditures
D. Wages paid to employees during the taxable year

66. Which advantage is available only in C corporation form?

A. Deductible owner fringe benefits and retained earnings at a flat rate
B. Pass-through of operating losses to the owners currently
C. Special allocations of income among the equity holders
D. Basis credit for entity-level borrowing from third parties

67. Which conversion triggers gain at both the entity and owner levels?

A. A sole proprietorship incorporating under Section 351
B. A C corporation liquidating to move assets to a pass-through
C. A C corporation electing to be taxed under Subchapter S
D. A partnership incorporating and then electing S status

68. Which figure is used in computing the shared responsibility payment for failing to offer coverage?

A. Full-time equivalents used to establish employer status

B. All employees including part-time workers, less thirty
C. Only employees who actually received a premium tax credit
D. Actual full-time employees reduced by thirty of their number

69. Which trust may not use a fiscal year?

A. An estate administering property following a death
B. A charitable trust exempt from tax under the Code
C. A qualified revocable trust making the combining election
D. An ordinary complex trust created under a decedent's will

70. Which adjustment is made in computing distributable net income?

A. The distribution deduction is subtracted from taxable income
B. Tax-exempt income is excluded from the computation entirely
C. Capital gains allocable to corpus are subtracted from the total
D. The personal exemption is subtracted a second time

71. Which beneficiary is taxed on income required to be distributed but not actually paid?

A. The first-tier beneficiary entitled to that mandatory income
B. The second-tier beneficiary receiving discretionary amounts
C. The remainder beneficiary succeeding to the trust corpus
D. No beneficiary, because nothing was actually distributed

72. Which requirement applies to an organization seeking retroactive recognition of exemption?

A. Filing within twelve months of the end of its first year
B. Filing within twenty-seven months of the month of formation
C. Obtaining a private letter ruling before commencing activity
D. Demonstrating that no taxable income arose in the interim

73. Which activity absolutely defeats an organization's charitable exemption?

A. Conducting an unrelated trade or business regularly
B. Attempting to influence legislation to a limited extent
C. Any part of net earnings benefiting a private insider
D. Accumulating funds rather than distributing them currently

74. Which income is pulled into unrelated business taxable income despite being passive?

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

75. Which contribution arrangement applies to a savings incentive match plan?

A. Employer contributions only, with no elective deferrals
B. Employee deferrals plus a mandatory employer match or nonelective
C. Discretionary employer contributions under a written formula
D. Employee deferrals only, with no employer contribution required

76. Which condition must be satisfied for a family member to be recognized as a partner where capital is material?

A. The member must contribute services of substantial value
B. The interest must have been acquired by purchase for cash
C. The member must be at least eighteen years of age
D. The member must genuinely own a capital interest in the firm

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

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

78. What must the donor be allocated before family partnership income is divided by capital?

A. A return equal to the prevailing market rate on capital
B. Reasonable compensation for services rendered to the firm
C. An amount equal to the donee's proportionate distribution
D. The full amount of any guaranteed payment agreed upon

79. Which item is not deductible by a trust in computing taxable income?

A. Fiduciary commissions paid for administering the trust
B. State and local taxes imposed on the trust's income
C. Expenses allocable to tax-exempt income received
D. Legal fees incurred in the trust's administration

80. Which exemption amount applies to a simple trust?

A. One hundred dollars, the complex trust amount
B. Six hundred dollars, matching the estate amount
C. No exemption is available to a simple trust
D. Three hundred dollars for the taxable year

81. Which election permits a distribution in early January to be treated as made in the prior year?

A. The combining election for a qualified revocable trust
B. The election to allocate expenses to tax-exempt income
C. The election to treat capital gains as distributable income
D. The sixty-five day election made annually on the return

82. Which organization must file the private foundation return?

A. Any exempt organization with assets above a stated threshold
B. Any organization failing the public support test in one year
C. Every private foundation regardless of receipts or assets
D. Only foundations making grants to foreign organizations

83. Which requirement applies to an activity claimed as substantially related?

A. It must contribute importantly to the exempt purpose itself
B. It must be conducted without any paid staff involvement
C. It must generate less than a stated proportion of receipts
D. It must be approved in advance by the Service in writing

84. Which livestock holding period applies to horses held for breeding?

A. Twelve months, matching livestock other than cattle
B. Twenty-four months from acquisition or from birth
C. Six months, as with ordinary short-term capital assets
D. No holding period requirement applies to any livestock

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

A. Soil and water conservation expenditures on the farmland
B. Prepaid feed, seed, and fertilizer purchased in advance
C. Veterinary and breeding fees for productive livestock

D. Depreciation on machinery used in field operations

86. Which taxpayer may elect farm income averaging?

A. A C corporation operating commercial crop production
B. An exempt organization running an agricultural program
C. An individual partner reporting farm income on a K-1
D. A trust holding farmland leased to an operating tenant

87. Which activity escapes the per se passive classification for rental activities?

A. One where the average period of customer use is five days
B. One where the owner spends more than five hundred hours
C. One where the owner personally approves every tenant
D. One where the property is held free of any mortgage debt

88. Which condition must a real estate professional satisfy in addition to the hours test?

A. Ownership of at least ten percent of every rental activity
B. Active participation in each separate rental activity owned
C. Licensure as a real estate agent or broker in the state
D. More than half of personal services in real property businesses

89. Which item is not rental income to a landlord?

A. A refundable security deposit the landlord must return
B. The fair market value of services accepted instead of rent
C. Payment received for cancelling an existing lease early
D. Expenses the tenant pays on the landlord's own behalf

90. Which threshold makes a dwelling a residence under the vacation home rules?

A. Personal use exceeding thirty days during the taxable year
B. Any personal use at all during the taxable year in question
C. Personal use exceeding half the days the property was rented
D. Personal use exceeding the greater of fourteen days or ten percent of rental days

91. Which retirement plan must be established by October first for the current year?

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

92. Which figure is used to compute a self-employed owner's own plan contribution?

A. Net profit reduced by the entire self-employment tax
B. Net profit before any adjustment whatever is made
C. Net profit reduced by half the self-employment tax
D. Gross receipts before deducting business expenses

93. Which prohibited transaction consequence applies to an individual retirement arrangement?

A. The entire account ceases to be an arrangement that year
B. Suspension of contributions for the following three years
C. A penalty equal to ten percent of the account balance
D. An excise tax applied to the amount involved only

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

A. Ordinary business income allocated to the shareholders
B. Separately stated income items passed through on the K-1
C. Tax-exempt interest earned on municipal obligations held
D. Gain recognized on a distribution of appreciated property

95. Which figure determines the taxability of an S corporation distribution where earnings and profits exist?

A. The shareholder's proportionate share of gross receipts
B. The four-tier ordering beginning with the adjustments account
C. The corporation's retained earnings shown on the balance sheet
D. The amount of cash actually available for distribution

96. Which item is subtracted from book income on the reconciliation?

A. Federal income tax expense recorded on the books
B. Nondeductible fines paid during the taxable year
C. The disallowed portion of business meals for the year
D. Excess of tax depreciation over book depreciation

97. Which condition permits a partnership to file an amended return with corrected Schedules K-1?

A. The partnership has validly elected out of the centralized regime
B. The partnership has fewer than ten partners for the year
C. The correction reduces rather than increases partnership income
D. The Service grants written permission to file the amendment

98. Which statement about unrelated business losses across several activities is correct?

A. Losses offset income from other unrelated activities freely
B. Losses are permanently disallowed in the year they arise

C. Each activity is computed separately with no cross-offsetting
D. Losses may offset the organization's exempt function income

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

A. Employment of at least twenty-five full-time equivalent workers
B. Payment of the entire premium cost for all covered employees
C. Availability for an unlimited number of consecutive years
D. Enrolment through the small business health options marketplace

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

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

Practice Exam 7: Answer Key and Explanations

1. B — Foreign defaults turn on liability rather than member count alone. A single member with unlimited liability produces disregarded treatment, while universal limited liability produces corporate treatment. Two or more members with at least one bearing unlimited liability produces partnership classification instead, inverting the logic applied to domestic entities entirely. Member count alone never decides a foreign entity's classification.

2. D — The effective date may be set as early as seventy-five days before the filing date or as late as twelve months after it, and absent a specified date the election takes effect on the filing date. All members must generally consent, and a sixty-month limitation then restricts further changes. Absent a stated date it takes effect on the filing date.

3. C — The Service may permit an earlier change where more than fifty percent of the ownership interests are held by persons who did not own any interest on the effective date of the prior election. The limitation also does not reach an entity's initial classification election made at formation. Initial classification at formation is separately exempt.

4. A — A new number is required only where a new entity comes into existence, which incorporation accomplishes. Name changes, address changes, opening additional locations, and changes in partnership membership all leave the same taxpayer in place. An S election likewise creates no new entity and requires no new number. An S election creates no new entity and needs no number.

5. B — A personal service corporation is confined to a calendar year unless it establishes a business purpose for a different one. A Section 444 election permits a deferral period of no more than three months, but it carries a minimum distribution requirement that limits deductions for amounts paid to owner-employees where unmet.

6. D — The form postpones the determination until the end of the presumption period, which is five years generally and seven for horse activities. Filing it extends the statute of limitations on the activity's items for those years, which is the cost of obtaining the deferral of the profit-motive question. The statute of limitations is extended for those years.

7. A — Illegal income is fully taxable; the character of the activity does not affect the obligation to report the proceeds. Gifts, loan proceeds, and owner capital contributions are not income at all. Bartered goods and services, recovered bad debts producing a tax benefit, and scrap sales are also business income. Gifts and loan proceeds are not income at all.

8. C — The holding period in the interest tacks only where the contributed property was a capital or Section 1231 asset. Contributions of cash or inventory begin a new period. The partnership's own holding period in contributed capital or Section 1231 property does include the contributor's period, which is a separate rule.

9. B — Section 704(c) requires items with respect to contributed property to be allocated so as to account for the difference between basis and value at contribution, returning precontribution appreciation to the contributor. Other allocations may follow the agreement provided they carry substantial economic effect or accord with the partners' interests. Other allocations may follow the agreement if respected.

10. D — A decrease in liability share is treated as a distribution of money, reducing basis and producing gain where it exceeds basis. It is not a loss and belongs in the distribution step of the ordering rather than the loss step, a placement that changes the answer whenever basis runs out.

11. C — Gain arises only where money distributed exceeds outside basis. Property other than money never triggers gain, because property simply absorbs basis rather than requiring it. Marketable securities are generally treated as money for this rule, so distributing publicly traded stock can produce gain where distributing land cannot. Marketable securities are generally treated as money here.

12. A — Relief from the seller's share of liabilities is included in the amount realized, so gain can arise on a sale producing modest cash and, in a heavily leveraged partnership, on one producing none. Section 751 then separates the ordinary component attributable to hot assets from the residual capital gain. Section 751 then splits ordinary from capital gain.

13. A — The election is made by the partnership rather than by partners, applies to all subsequent transfers, and remains in effect until revoked with permission. The resulting adjustment aligns a transferee's share of inside basis with outside basis, and becomes mandatory where a substantial built-in loss exists after any transfer. A substantial built-in loss makes the adjustment mandatory.

14. D — The representative need not be a partner but must have a substantial presence in the United States, and where an entity is designated a designated individual must act on its behalf. The representative holds exclusive authority to bind the partnership and every partner in any proceeding under the regime. Exclusive authority binds every partner in any proceeding.

15. C — The partnership computes an imputed underpayment by netting the adjustments and applying the highest rate applicable to individuals or corporations, and pays that amount in the adjustment year. Modification procedures may reduce it where partners amend returns or where some partners are tax-exempt or taxed at lower rates. Modification procedures may reduce the amount payable.

16. B — Control requires at least eighty percent of the total combined voting power of all voting classes and at least eighty percent of the total number of shares of each other class. Both prongs must hold, and the second is measured by share count within each class rather than by aggregate value.

17. A — Control must be genuine rather than momentary. A transferor contractually bound to dispose of shares to an outsider is generally not counted, because the control is illusory. The word immediately does not require simultaneity, however, so transfers on different dates forming one integrated plan are aggregated together. Integrated plans across dates are nevertheless aggregated.

18. D — Assumption of a liability is generally not treated as money received and therefore is not boot; it reduces the shareholder's stock basis instead. Gain arises only where liabilities exceed the basis of property transferred, or where a tax avoidance purpose converts the entire liability into boot received. Excess liabilities over basis produce gain instead.

19. C — Ineligible corporations include certain financial institutions using the reserve method for bad debts, insurance companies taxed under the special provisions, and domestic international sales corporations. Ninety-five individual shareholders, dual classes differing only in voting rights, and ownership of a subsidiary are all entirely compatible with an election. Dual classes differing only in voting rights are permitted.

20. A — Where an S corporation owns all the stock of a domestic corporation it may elect to treat the subsidiary as a qualified subchapter S subsidiary, after which the subsidiary is disregarded and its items are treated as the parent's. The election isolates liability without creating a second federal tax entity.

21. B — Tax-exempt income increases basis despite never being taxed, preserving the exemption on eventual disposition of the shares. Distributions, nondeductible noncapital expenses, and separately stated deductions all reduce basis in that order after increases, with an election available to reverse the final two steps of the sequence. Distributions and losses reduce basis in a set order.

22. C — Losses reduce stock basis first and debt basis second, while restoration runs in the opposite direction. A net increase restores debt basis up to the amount previously reduced before any stock basis is rebuilt, protecting the shareholder's loan ahead of the equity investment in the corporation. Suspended losses become deductible as basis returns.

23. B — Where the corporation ceases to satisfy any eligibility requirement the election terminates immediately on the date of the disqualifying event. A transfer of even a single share to a partnership, corporation, or nonresident alien accomplishes this, and the year then splits into an S short year and a C short year.

24. D — A corporation whose election terminated generally may not elect again until the fifth taxable year after the year of termination. Consent to an earlier election is more readily given where the termination followed an ownership change outside the control of the corporation or its majority shareholders at the time. Ownership changes outside the corporation's control help.

25. B — Charitable contributions are separately stated because the limitations are computed on each shareholder's own return, so aggregating them would destroy information the shareholder needs. Routine depreciation, rent, and utilities carry no shareholder-level variation and are aggregated into ordinary business income on page one of the return. Limits are computed on each shareholder's own return.

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

27. D — A shareholder owning more than two percent cannot exclude most fringe benefits. Premiums are included in Box 1 of the Form W-2 and deducted by the corporation as compensation, after which the shareholder claims the self-employed health insurance deduction. Properly structured they escape Social Security and Medicare tax. The corporation deducts the amount as compensation.

28. A — Repairs carry no owner-level variation and are aggregated into ordinary business income. Section 179 expense, foreign taxes, and capital gains all face limitations or elections operating at the owner level, so each must be stated separately to preserve the information every owner needs for their own return. Owner-level elections must be preserved separately.

29. B — The four hurdles run in a fixed sequence and basis is tested first. Only the amount surviving that test is measured against amounts at risk, then against passive income, and finally against the excess business loss cap. A loss stopped at any hurdle never reaches the next one at all.

30. D — Tax shelters may never use the cash method whatever their size. Other taxpayers may use it where they fall below the gross receipts test, which is the same threshold governing exemption from required inventory accounting and from the uniform capitalization rules applying to producers and resellers alike. The same threshold governs inventories and capitalization.

31. A — First-in, first-out may be combined with lower of cost or market valuation, while last-in, first-out may not. That method additionally carries a conformity requirement obliging the taxpayer to use it in reports to shareholders, partners, and creditors rather than showing higher earnings to lenders elsewhere. Conformity binds reports to shareholders and creditors.

32. C — Purchasing department costs are among the indirect costs a reseller must capitalize, along with handling, processing, repackaging, storage, and warehousing of goods awaiting sale. Advertising, selling commissions, and delivery of goods to customers all remain currently deductible period costs outside the capitalization requirement entirely. Period costs remain deductible outside the requirement.

33. D — Amounts protected against loss through guarantees, stop-loss agreements, or similar arrangements are excluded, as is nonrecourse financing and property used in the activity pledged as security. Cash, contributed property basis, and genuinely recourse borrowing all count toward the at-risk figure limiting deductible losses. Nonrecourse financing is likewise excluded entirely. Pledged activity assets add no personal exposure.

34. C — Recourse debt bifurcates. Gain or loss on the disposition is measured against fair market value, and any remaining debt forgiven above that value is cancellation income. Nonrecourse debt behaves entirely differently, with the full debt entering the amount realized and producing no cancellation income whatever. The character of the debt decides the whole analysis.

35. B — The prescribed order begins with net operating losses, then general business credits, the minimum tax credit, capital loss carryovers, basis of property, passive activity carryovers, and finally foreign tax credits. An election permits reducing depreciable property basis first, preserving a currently usable loss at the cost of future depreciation. The reduction equals the amount excluded, not forgiven.

36. A — In a C corporation the danger runs toward compensation that is too high, since excessive amounts paid to a shareholder-employee become dividends, nondeductible by the corporation yet fully taxable to the recipient. The S corporation risk reverses entirely, with understated compensation recharacterized as wages bearing employment taxes. Double taxation falls on the disallowed portion exactly.

37. D — A child under eighteen employed by a parent's sole proprietorship, or by a partnership in which each partner is a parent, is exempt from Social Security and Medicare tax and remains exempt from unemployment tax until twenty-one. Spouses and parents are subject to Social Security while exempt from unemployment tax.

38. B — A self-rental at reasonable rent is respected, with the business deducting rent and the owner reporting rental income. Under the self-rental rule, net rental income from property leased to a business in which the owner materially participates becomes nonpassive, while net rental losses from the same arrangement remain passive. Losses from the same arrangement nonetheless stay passive.

39. C — Meals sold to customers in the ordinary course remain fully deductible, as do meals treated as compensation and meals at company-wide recreational events primarily benefiting employees. Entertainment produces no deduction at all, and food at an entertainment event is fifty percent deductible only where separately stated. Separately stated food at an event is fifty percent deductible.

40. A — Self-employed taxpayers may use the meal portion of the published allowance but must substantiate actual lodging cost, as must owners of more than ten percent of a business. Time, place, and business purpose still require substantiation whatever method is used for the amount of the expense claimed. Owners of more than ten percent face the same restriction.

41. C — A taxpayer claiming Section 179 expensing or accelerated depreciation on a vehicle may never use the standard mileage rate for that vehicle in a later year. The rate is also unavailable for five or more simultaneous vehicles, and must generally be elected in the first year to preserve flexibility. Five or more simultaneous vehicles also bar the rate.

42. B — Interest follows the use of the proceeds rather than the collateral, so a residence-secured loan deployed in business produces business interest. A loan secured by business assets and spent personally produces nondeductible personal interest. Prepaid interest is capitalized, and interest to carry tax-exempt obligations is disallowed entirely. Tracing governs the answer in both directions equally.

43. A — Rebuilding property to like-new condition after the end of its class life is a restoration requiring capitalization, as is replacing a major component or substantial structural part. Cleaning, patching, replacing worn parts, and routine painting all keep property in ordinarily efficient operating condition and remain currently deductible. The standard applies separately to nine building systems.

44. D — A taxpayer without an applicable financial statement must have a written accounting policy in place at the beginning of the tax year to use the de minimis safe harbor, and it cannot be adopted retroactively when the return is prepared. The other provisions carry their own separate and distinct conditions.

45. D — Qualified improvement property carries a fifteen-year recovery period and is eligible for Section 179 expensing, as are roofs and heating, fire protection, and security systems on nonresidential real property. Office furniture is seven-year property, computers are five-year, and the building structure itself remains thirty-nine years. Section 179 reaches these systems but not the structure.

46. C — Section 1245 recaptures all prior depreciation as ordinary income before any Section 1231 treatment is available, so the ordinary component equals the lesser of depreciation claimed or total gain. Real property follows the gentler Section 1250 rule recapturing only depreciation claimed in excess of straight line. Recapture is full rather than partial for personal property.

47. A — Section 1031 now applies exclusively to real property held for productive use in a trade or business or for investment. Equipment, vehicles, livestock, and partnership interests are excluded in every circumstance. Material describing equipment trade-ins as like-kind exchanges describes law repealed several years ago entirely. Personal property no longer qualifies in any circumstance.

48. B — Replacement property must be identified within forty-five days of transferring the relinquished property, and the exchange must close within one hundred eighty days or by the return due date including extensions, whichever comes first. Both deadlines are strict and failing either converts the transaction into a taxable sale. Failing either deadline converts it into a taxable sale.

49. D — Capital gains and losses are excluded, as are dividends, investment interest, foreign income, S corporation reasonable compensation, partnership guaranteed payments, and income from performing services as an employee. Ordinary income from a domestic trade or business, including qualifying rental activity, remains within the definition. Employee service income is likewise excluded entirely.

50. C — Below the threshold the computation is simple: twenty percent of qualified business income capped by twenty percent of taxable income reduced by net capital gain. No wage figures are needed, no property basis is needed, and the nature of the business is entirely irrelevant to the outcome. Most returns claiming the deduction never go further.

51. A — Architecture and engineering are conspicuously absent from the statutory list despite appearing in comparable provisions elsewhere in the Code. Both retain the deduction at any income level, subject only to the wage and property limitations. Financial services, performing arts, and actuarial science all appear on the list and lose it.

52. D — The second limb adds twenty-five percent of W-2 wages to two and a half percent of the unadjusted basis of qualified property immediately after acquisition. Unadjusted basis means original cost without reduction for depreciation, and the taxpayer claims whichever of the two limbs produces the larger figure. Unadjusted basis ignores depreciation already claimed.

53. B — Where the net across all qualified businesses is negative, the loss carries forward and reduces qualified business income in the following year. It neither creates a current deduction nor disappears, which prevents a taxpayer claiming the deduction on profitable businesses while ignoring losses generated elsewhere in the same year. It prevents claiming the deduction while ignoring losses.

54. B — The aggregated credit carries back one year and forward twenty, used first in first out so the oldest credits are absorbed first and expire least often. A credit reaching the end of the twenty-year period unused becomes deductible in that year rather than simply disappearing from the taxpayer's account. An expiring credit becomes deductible in that final year.

55. A — The deduction is capped at eighty percent of taxable income computed without the net operating loss deduction and without the qualified business income deduction. Computing eighty percent of income already reduced by the loss produces a circular and wrong answer offered as a standard distractor in these questions. That circular figure is a standard distractor offered.

56. C — Life insurance proceeds are book income that is never taxable, so the difference never reverses. Bad debt allowances, warranty reserves, and depreciation timing all reverse in later periods and are temporary differences affecting when tax is paid rather than the effective rate the corporation ultimately bears. Permanent differences change the effective rate borne.

57. B — A positive adjustment increasing income spreads ratably over four years beginning with the year of change, while a negative adjustment decreasing income is taken entirely in that year. The asymmetry softens the cost of correcting a favourable but impermissible method and encourages voluntary correction rather than waiting for examination. Voluntary correction also brings audit protection generally.

58. D — The threshold is total assets of ten million dollars or more. Schedule M-3 requires each difference to be separated into permanent and temporary columns and the source of book income identified, supplying detail that Schedule M-1's aggregated single-line disclosures concealed from examiners reviewing larger returns. Aggregated single-line disclosures concealed that detail.

59. A — Removing documented non-income deposits such as loan proceeds and owner transfers, then comparing the remainder to reported receipts, reveals income that never reached the books. A rollforward that ties proves only that whatever was recorded was recorded consistently, not that the record was complete in the first place. A tying rollforward proves consistency, not completeness.

60. C — A significant unreimbursed investment is a financial control indicator, along with opportunity for profit or loss, availability to the market generally, and payment by the project rather than by regular wage. Detailed instructions and training are behavioral control factors, and employee benefits indicate the type of relationship. Behavioral factors point the other way toward employment.

61. C — All three conditions must hold simultaneously. The reporting consistency requirement defeats most claims in practice, because an employer who failed to file information returns for the workers cannot obtain relief regardless of how reasonable the original basis was or how consistently the workers were treated. Unfiled information returns defeat the claim outright.

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

63. A — The penalty reaches any responsible person, meaning anyone with the authority and duty to direct payment, which can include officers, bookkeepers, and occasionally outside advisors. Wilfulness requires only knowledge that taxes were unpaid plus a decision to pay other creditors instead, with no intent to defraud required. The liability survives dissolution and bankruptcy alike.

64. D — Basis records must survive as long as the asset does and then through the limitations period for the year of disposition, which for real property can mean several decades. A taxpayer unable to substantiate basis on sale faces gain computed from a basis of zero, an expensive failure of recordkeeping.

65. C — A statutory rule requires documentary evidence of amount, time, place, business purpose, and where relevant business relationship for these categories, so an unsubstantiated expense is disallowed entirely however plainly incurred. Reasonable estimation of a clearly incurred but imprecisely documented expense remains available outside that statutory list. Business relationship must also be shown where relevant.

66. A — Deductible owner fringe benefits, a fiscal year free of pass-through constraints, retention of earnings at a flat entity rate, and the small business stock gain exclusion are available in no other form. Losses trap at the entity level, special allocations are a partnership feature, and entity debt gives no shareholder basis.

67. B — Liquidating a C corporation triggers gain at both the corporate and shareholder levels, which makes a C corporation holding appreciated assets practically impossible to unwind. Moving into corporate form is generally tax free, and electing S status carries only the built-in gains exposure across a five-year recognition period. Appreciated assets make the structure effectively permanent.

68. D — The payment is computed on actual full-time employees reduced by thirty, not on the full-time equivalent figure used only to determine whether the employer has the status. Part-time employees count toward establishing status but are never owed an offer of coverage and never enter the payment computation. Equivalents establish status but never the payment base.

69. D — Trusts must use a calendar year with narrow exceptions for tax-exempt and charitable trusts. Estates may adopt any fiscal year ending within twelve months of death, and a qualified revocable trust making the combining election shares the estate's year together with its two-year exemption from estimated tax payments. Charitable and exempt trusts are the narrow exceptions.

70. C — Capital gains allocable to corpus are subtracted because they belong to the remainder beneficiary rather than the income beneficiary. The distribution deduction and personal exemption are added back, and tax-exempt income net of allocable expenses is added, producing a figure approximating income economically available for current distribution. Corpus gains belong to the remainder beneficiary instead.

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

72. B — Filing within twenty-seven months of the end of the month of formation produces recognition retroactive to the date of formation. A later filing produces recognition only prospectively from the application date, leaving a taxable gap for the intervening period during which the organization operated without recognized status. A taxable gap covers the intervening unrecognized period.

73. C — Private inurement is prohibited absolutely with no threshold and no substantiality test, so any part of net earnings benefiting an insider defeats exemption outright. Lobbying is permitted within limits, and unrelated business activity produces tax rather than revocation unless it becomes the organization's primary purpose. Unrelated business activity produces tax, not revocation.

74. A — Debt-financed income is pulled in proportion to the outstanding acquisition indebtedness even where it would otherwise be excluded as passive. Dividends, interest, royalties, and unencumbered rents from real property are all ordinarily excluded, making the presence of a mortgage the decisive fact in these questions. A mortgage is therefore the decisive fact in these items.

75. B — Employees make elective deferrals within a limit lower than ordinary deferral plans, and the employer must either match dollar for dollar up to three percent of compensation or contribute two percent nonelectively for every eligible employee. Both formulas are mandatory rather than discretionary, and all contributions vest immediately. Contributions vest immediately in every such plan.

76. D — Where capital is a material income-producing factor, a family member owning a genuine capital interest is recognized even if acquired by gift. The interest must be real, with the donee holding the rights of ownership rather than nominal title while the donor retains practical control over it. Nominal title with retained donor control does not suffice.

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

78. B — The donor must first be allocated reasonable compensation for services rendered, with only the remaining income divided according to capital interests. Beyond that, the donee's share attributable to capital may not be proportionately greater than the donor's share attributable to the same capital in the business. Capital shares are then compared proportionately between them.

79. C — Expenses attributable to the production of tax-exempt income are not deductible, and where an expense relates to both taxable and exempt income it must be apportioned, customarily by the ratio of tax-exempt income to total income. Fiduciary commissions, state taxes, and administration legal fees are all deductible. Apportionment uses the ratio of exempt to total income.

80. D — The exemption is three hundred dollars for a simple trust required to distribute all income currently, one hundred for a complex trust, and six hundred for an estate. These amounts are fixed by statute rather than indexed for inflation, making them safely memorized regardless of which year is tested. Estates receive six hundred and complex trusts one hundred.

81. D — The election allows a distribution made within the first sixty-five days of a year to be treated as made on the last day of the preceding year. Because fiduciary brackets compress rapidly, shifting income to beneficiaries usually helps, and the election permits that decision after the year's results are known.

82. C — All private foundations file the private foundation return whatever their receipts or assets. Other organizations file the electronic notice, the short form, or the full return according to gross receipts and total assets measured on a three-year normally basis rather than tested in any single year. Receipts are measured on a three-year normally basis.

83. A — The activity must contribute importantly to accomplishing the exempt purpose, other than through the production of funds. A museum shop selling reproductions of works in its collection qualifies; the same shop selling unrelated consumer goods does not. The organization's need for money never establishes substantial relation. Producing funds alone never establishes that relation.

84. B — Cattle and horses require twenty-four months, while other livestock held for draft, breeding, dairy, or sporting purposes require twelve. Poultry is excluded by statute entirely, and animals held primarily for sale remain ordinary income property regardless of how long the farmer happens to hold them. Poultry is excluded from the provision by statute.

85. B — Prepaid farm supplies are limited to fifty percent of other deductible farm expenses, with exceptions for farmers meeting a substantial-business test or where unusual circumstances caused the excess. Soil and water conservation expenditures face the separate twenty-five percent of gross farm income limit with an indefinite carryforward. Conservation costs face a separate percentage limit.

86. C — Averaging is available only to individuals, including partners and S corporation shareholders reporting farm income from those entities, and never to C corporations. Base year income serves only as a computational reference so those earlier returns are unaffected, and the election may be made or changed on an amended return.

87. A — An activity where the average period of customer use is seven days or less is not a rental activity at all and is tested under ordinary material participation standards. Hours devoted, personal involvement in tenant selection, and the absence of debt do not affect the categorical rental classification. Rental activities are otherwise passive per se always.

88. D — Both conditions must hold in the same year: more than half of all personal services performed in any trade or business must be in real property trades or businesses in which the taxpayer materially participates, together with more than seven hundred fifty hours devoted to those businesses that year. Material participation must then be shown for each activity.

89. A — A refundable deposit is not income while the landlord remains obligated to return it, becoming income only when applied to unpaid rent or retained for damage. Lease cancellation payments, services accepted instead of rent, and tenant-paid landlord expenses are all included in rental income when received. Advance rent is income on receipt whatever the method.

90. D — Exceeding the greater of fourteen days or ten percent of the days rented at fair value makes the property a residence, limiting deductions to rental income with no loss permitted and disallowed amounts carried forward. Below that threshold the property is not a residence and a loss may be claimed.

91. B — The plan must generally be established by October first for the year it is to be effective, a deadline carrying no extension. A simplified employee pension by contrast may be established and funded as late as the extended due date, making it the only option for a business acting after year end.

92. C — Net earnings for plan purposes equal net profit reduced by the deductible half of self-employment tax. The stated plan rate is then converted by dividing it by one plus itself, which resolves the circularity created because the contribution itself reduces the base on which it is computed. Twenty-five percent converts to twenty percent this way.

93. A — The entire account ceases to be an individual retirement arrangement as of the first day of the year, producing a deemed distribution of the whole balance. This is dramatically harsher than the excise tax applying to a qualified plan, and prompt correction does not cure it once the transaction occurs.

94. C — Tax-exempt income does not increase the account and its related expenses do not decrease it, though both affect stock basis. Ordinary income, separately stated income, and recognized gains all increase it. Distributions reduce it only to zero, while losses may drive the balance negative in a poor year. Distributions reduce it only as far as zero.

95. B — The order runs the accumulated adjustments account first, tax free to the extent of stock basis, then accumulated earnings and profits as a dividend, then remaining stock basis, then capital gain. An election may reverse the first two tiers where the corporation faces passive investment income exposure. An election may reverse the first two of those tiers.

96. D — Excess tax depreciation is a deduction taken for tax but not recorded on the books, so it is subtracted, as are tax-exempt interest and life insurance proceeds. Federal income tax, nondeductible fines, and the disallowed meal portion all reduced book income without being deductible and are added back. Book income that is not taxable is likewise subtracted.

97. A — A partnership subject to the centralized regime cannot amend and must file an administrative adjustment request instead. Only a partnership that has validly elected out, or an S corporation, may file an amended return with corrected statements. Electing out requires both the numerical and the partner eligibility conditions. Both numerical and eligibility conditions must be met.

98. C — Income and deductions must be computed separately for each unrelated trade or business, so a loss from one cannot offset income from another. Losses are trapped within their own activity and carried forward against that activity's future income, preventing the sheltering of profitable operations behind unprofitable ones. Losses carry forward within their own activity silo.

99. D — Eligibility requires fewer than twenty-five full-time equivalent employees, average annual wages below an adjusted ceiling, payment of at least half the premium cost under a qualifying arrangement, and enrolment through the small business marketplace. The credit is available for only two consecutive years and phases out as figures rise. The credit phases out as headcount or wages rise.

100. B — The hurdles operate in a fixed sequence and each is tested against the amount that survived the previous one, never against the original loss. Basis comes first, then at-risk, then passive activity, then the excess business loss cap, whose disallowed remainder becomes a net operating loss carryforward. Basis, at-risk, passive, then the excess business loss cap.