PRACTICE EXAM 8: 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 arrangement is treated as a partnership rather than mere co-ownership?

A. Two owners dividing rent from a jointly held building
B. Two owners holding undeveloped land for appreciation
C. Two owners sharing proceeds from an occasional land sale
D. Two owners providing substantial services to occupants

2. Which classification election is unavailable to a state-law corporation?

A. The election to be taxed under Subchapter S provisions
B. The election to be classified as a partnership entity
C. The election to adopt a calendar taxable year initially
D. The election to use the accrual method of accounting

3. How is a single-member domestic limited liability company treated absent an election?

A. As a partnership because the entity form permits members
B. As an association taxable as a corporation by default
C. As disregarded, with activity on the member's own return
D. As a trust because a single beneficial owner exists

4. Which taxpayer may adopt a fifty-two or fifty-three week tax year?

A. A business whose operations run on weekly cycles
B. Only corporations with publicly traded securities outstanding
C. Only taxpayers using the accrual method of accounting
D. Only entities exempt from tax under the Code

5. Which test does a partnership apply first in determining its required tax year?

A. The majority interest tax year of partners owning over half
B. The least aggregate deferral computation across candidates
C. The tax year used by all of its principal partners
D. The calendar year, as a mandatory default for partnerships

6. Which activity uses the two-of-seven-years profit presumption?

A. Commercial farming producing row crops for market sale
B. Breeding, training, showing, or racing of horses
C. Charter fishing conducted from an owned vessel
D. Antique dealing conducted from a retail storefront

7. Which item is business income despite involving no cash receipt?

A. A capital contribution made by the business owner
B. Loan proceeds deposited into the operating account
C. A transfer of funds from a personal savings account
D. Goods or services accepted in a barter exchange

8. Which basis does a partnership take in property received from a partner?

A. Fair market value determined on the contribution date
B. The average of adjusted basis and fair market value
C. The contributing partner's adjusted basis carried over
D. Zero until the property is placed in service by the firm

9. Which item does a partner's initial outside basis include?

A. The fair market value of contributed appreciated property
B. The partnership's inside basis in all of its assets
C. The partner's share of partnership liabilities assumed
D. The projected value of future distributive shares

10. Which loss is suspended rather than deducted where a partner's basis is insufficient?

A. The portion attributable to nonrecourse financed activity
B. The excess of the allocated loss over outside basis
C. The entire loss allocated on the Schedule K-1
D. The portion attributable to separately stated deductions

11. Which payment to a partner is deductible by the partnership if otherwise deductible?

A. A guaranteed payment for services rendered to the firm
B. A distribution of cash reducing the partner's basis
C. An allocation of ordinary business income for the year
D. A repayment of capital previously contributed by a partner

12. What is the consequence of a partnership distributing contributed property to another partner within seven years?

A. The distributee recognizes the built-in gain immediately
B. The partnership recognizes gain equal to the appreciation
C. No consequence, since distributions are generally nontaxable
D. The contributing partner recognizes the remaining built-in gain

13. Which partner's loss is generally excluded from self-employment income?

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

14. Which condition must exist for a partnership to terminate under current law?

A. Fifty percent of the interests change hands within a year
B. The partnership sells substantially all of its operating assets
C. The partnership agreement provides for dissolution by date
D. No part of any business continues in partnership form

15. Which item may convert a partner's abandonment loss from ordinary to capital?

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

16. Which requirement applies to a partnership electing out of the centralized audit regime?

A. It must have fifty or fewer partners for the taxable year
B. It must obtain advance written consent from the Service
C. It must notify each partner within thirty days of electing

D. It must have been in existence for at least three years

17. Which interest rate applies where partners pay under a push-out election?

A. The ordinary underpayment rate applicable to individuals
B. Two percentage points above the ordinary underpayment rate
C. The federal short-term rate without any additional margin
D. A rate fixed by the partnership representative in the statement

18. Which shareholder receiving stock for services is nevertheless counted toward Section 351 control?

A. One receiving stock solely for legal services rendered
B. One receiving stock solely for management consulting
C. One transferring property of more than relatively small value
D. One receiving stock for services in a later taxable year

19. Which item is not boot in a Section 351 exchange?

A. Voting common stock issued by the transferee corporation
B. A long-term debt security issued by the corporation
C. Nonqualified preferred stock with mandatory redemption
D. Cash paid to equalize the values being exchanged

20. Which corporation is treated as part of a parent-subsidiary controlled group?

A. One in which the parent owns forty percent of voting power
B. One in which five individuals own eighty percent collectively
C. One sharing common officers with the parent corporation
D. One in which the parent owns eighty percent of voting power or value

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

A. Life insurance proceeds received on a key employee policy
B. Federal income taxes paid during the taxable year
C. Nondeductible fines assessed by a regulatory agency
D. Premiums paid where the corporation is the beneficiary

22. How is a distribution treated where it exceeds earnings and profits and the shareholder's basis?

A. As an ordinary dividend for the full amount distributed
B. As a tax-free return of capital for the entire excess
C. As capital gain from a deemed sale of the stock
D. As compensation subject to employment tax withholding

23. Which corporation faces the personal holding company tax?

A. One accumulating earnings beyond its reasonable business needs
B. One with more than half its gross receipts from services
C. One failing either the ownership or the income test alone
D. One meeting both the ownership and passive income tests

24. Which trust qualifies as an S corporation shareholder?

A. A foreign trust with United States beneficiaries named
B. A qualified subchapter S trust that has made the election
C. An irrevocable trust whose beneficiary is a partnership
D. A charitable remainder trust holding the shares outright

25. Which item reduces an S corporation shareholder's stock basis before losses are applied?

A. Distributions not includible in the shareholder's income
B. Tax-exempt income allocated for the taxable year
C. Additional capital contributed during the taxable year
D. Increases in the corporation's outstanding indebtedness

26. Which limitation applies to an S corporation shareholder's deductible loss?

A. Stock basis alone, without regard to any shareholder loans
B. Stock basis plus the shareholder's share of corporate debt
C. Stock basis plus debt basis from direct shareholder loans
D. Stock basis plus any amounts personally guaranteed by the holder

27. Which item does not increase an S corporation's accumulated adjustments account?

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

28. Which condition must exist before the passive investment income termination can apply?

A. The corporation must have at least five shareholders
B. Passive income must exceed half of the gross receipts
C. The corporation must have elected S status recently
D. The corporation must have accumulated earnings and profits

29. Which method must a taxpayer use where average gross receipts exceed the applicable threshold?

A. The cash method, with inventories treated as supplies
B. A hybrid method combining cash and accrual elements
C. The completed contract method for all long-term work

D. The accrual method of accounting for the business

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

A. Freight charges incurred in acquiring the merchandise
B. Merchandise withdrawn by the owner for personal use
C. Trade discounts allowed by the supplier on invoices
D. Storage costs for goods awaiting eventual sale

31. Which taxpayer is exempt from the uniform capitalization rules?

A. Any taxpayer producing property for sale to customers
B. Any taxpayer acquiring merchandise for resale to the public
C. A taxpayer meeting the applicable gross receipts test
D. A taxpayer using the accrual method of accounting

32. Which item is excluded from a taxpayer's at-risk amount?

A. Nonrecourse financing obtained for an equipment activity
B. Cash contributed directly to the activity by the taxpayer
C. Property contributed at its adjusted basis to the activity
D. Borrowed amounts for which the taxpayer is personally liable

33. Which discharge produces no cancellation of indebtedness income?

A. A seller-financed purchase price reduction for a solvent buyer
B. A creditor writing off a portion of an equipment loan
C. A supplier forgiving a trade payable owed by the business
D. A lender reducing the principal on an operating line of credit

34. Which item is reduced first when a taxpayer excludes cancellation income?

A. The basis of depreciable property held by the taxpayer
B. General business credit carryovers from earlier years
C. Net operating loss carryovers available to the taxpayer
D. Foreign tax credit carryovers accumulated to date

35. Which compensation deduction risk arises in an S corporation?

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

36. Which family employment arrangement is exempt from federal unemployment tax?

A. A child aged twenty-two employed by a parent's proprietorship
B. Any family member employed by a family S corporation
C. A child aged twenty-five employed by a parent's partnership
D. A spouse employed by the other spouse's sole proprietorship

37. Which arrangement produces a currently deductible rent expense?

A. A lease where title passes automatically at the term's end
B. A lease with a nominal purchase option at expiry
C. A lease where payments materially exceed fair rental value
D. A lease of property in which the tenant holds no equity

38. Which travel expense is deductible where a domestic trip is primarily personal?

A. Round-trip transportation to and from the destination
B. Expenses at the destination directly attributable to business
C. Lodging for the entire duration of the trip taken
D. Meals for every day of the trip at fifty percent

39. Which meal remains fully deductible rather than subject to the fifty percent limit?

A. A meal provided on the premises for the employer's convenience
B. A meal with a client at a restaurant near the office
C. A meal treated as compensation and included in wages
D. A meal purchased during deductible business travel

40. Which condition must an accountable plan satisfy?

A. Return of any excess advance by the employee to the employer
B. Advance approval of each expenditure by a company officer
C. Payment of reimbursements within the same calendar quarter
D. Reimbursement at no more than the federal per diem rate

41. Which basis figure applies to property converted from personal to business use?

A. The original cost without regard to any decline in value
B. Fair market value at the date of the conversion
C. The lower of adjusted basis or value at conversion
D. The higher of adjusted basis or value at conversion

42. Which convention applies to nonresidential real property?

A. The half-year convention used for most personal property
B. The mid-month convention regardless of the placement date
C. The mid-quarter convention where the threshold is exceeded

D. A full-year convention because the recovery period is long

43. Which property is eligible for Section 179 expensing?

A. The structural shell of a newly constructed office building
B. Land acquired for the construction of a warehouse facility
C. Residential rental property acquired during the year
D. A security system installed on nonresidential real property

44. Which item is recovered over fifteen years?

A. Land improvements such as fencing and drainage tile
B. Machinery used directly in manufacturing operations
C. Office furniture with no designated class life assigned
D. General purpose farm buildings housing operations

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

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

46. Which exchange still qualifies for nonrecognition under Section 1031?

A. Business equipment traded for similar replacement equipment
B. Rental real property exchanged for undeveloped farmland
C. A partnership interest exchanged for another such interest
D. Breeding livestock exchanged for animals of the same sex

47. Which item is excluded from qualified business income?

A. Reasonable compensation paid to an S corporation shareholder
B. Rental income from a domestic trade or business activity
C. Ordinary income from a domestic manufacturing partnership
D. Section 179 expense allocated on the Schedule K-1

48. Which business retains the qualified business income deduction at any income level?

A. A consulting practice advising corporate management clients
B. An accounting firm preparing tax and audit engagements
C. A brokerage dealing in securities for its own clients
D. An engineering firm providing structural design services

49. Which carryback applies to a net operating loss arising after 2017?

A. Two years for most business losses of any taxpayer
B. Five years for losses of corporations only
C. Three years for losses arising from casualty events
D. None, except two years for qualifying farming losses

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

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

51. Which item is added back in reconciling book income to taxable income?

A. Tax-exempt interest earned on municipal obligations held
B. Federal income tax expense recorded on the corporate books
C. Excess of tax depreciation over the book depreciation figure
D. Life insurance proceeds received on a key employee

52. Which figure must agree with the equity section of the balance sheet?

A. The reconciliation of book income to taxable income
B. The identification of substantial stock ownership interests
C. The closing balance on the retained earnings analysis
D. The detail of permanent and temporary differences reported

53. Which change is a change in accounting method requiring consent?

A. Correcting a mathematical error in one year's depreciation
B. Transposing two digits when reporting gross receipts once
C. Omitting a single deductible expense in one taxable year
D. Using an impermissible treatment consistently across two returns

54. Which protection does voluntary filing of a method change request generally provide?

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

55. Which item on a partnership Schedule K-1 directly affects a partner's outside basis?

A. The partner's share of liabilities reported by category
B. The partnership's total assets shown on the balance sheet
C. The identity of the designated partnership representative

D. The partnership's gross receipts for the taxable year

56. Which factor supports treating a worker as an employee?

A. The worker markets services to the general public regularly
B. The business gives detailed instructions on work methods
C. The worker maintains a substantial unreimbursed investment
D. The worker can realize a profit or suffer a genuine loss

57. Which failure defeats statutory relief from worker reclassification liability?

A. Reliance on a long-standing practice within the industry
B. Reliance on a prior examination that raised no issue
C. Failure to file information returns for the workers
D. Treating some workers differently in an earlier year

58. Which record retention period applies to employment tax records?

A. Three years from the date the return was filed
B. Four years after the tax becomes due or is paid
C. Six years from the close of the calendar year involved
D. Until the related employees leave the business permanently

59. Which consequence follows commingling of business and personal funds?

A. Deductions become harder to sustain and liability protection weakens
B. The business must automatically convert to a sole proprietorship
C. The entity is required to obtain a new identification number
D. All distributions become taxable dividends to the owner

60. Which withdrawal produces no tax event at all?

A. A shareholder withdrawing cash from a C corporation
B. A partner withdrawing cash exceeding outside basis
C. An S corporation shareholder withdrawing beyond basis
D. A sole proprietor withdrawing cash from the business

61. Which entity choice best suits a leveraged start-up expecting early losses?

A. A C corporation retaining earnings at the flat entity rate
B. A partnership where entity debt supports the owners' basis
C. An S corporation where guarantees establish shareholder basis
D. A personal service corporation confined to a calendar year

62. Which allocation must a buyer and seller report consistently on an asset sale?

A. The allocation of purchase price across the asset classes
B. The allocation of employees between the two businesses
C. The allocation of the seller's prior year loss carryovers
D. The allocation of accrued liabilities to future periods

63. Which item is recognized entirely in the year of sale under the installment method?

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

64. Which employer must count part-time employees in determining its status?

A. One measuring eligibility for the small employer health credit
B. One determining its deposit schedule for employment taxes
C. One determining applicable large employer status for coverage
D. One computing its deduction limit for retirement contributions

65. Which trust classification applies where the grantor retains a power to revoke?

A. A simple trust required to distribute all income currently
B. A complex trust permitted to accumulate income annually
C. A grantor trust disregarded for income tax purposes
D. An electing small business trust holding operating stock

66. Which figure caps the amount beneficiaries may be taxed on collectively?

A. The fiduciary accounting income for the taxable year
B. The distributable net income for the taxable year
C. The total amount actually distributed during the year
D. The trust's taxable income before any deduction

67. Which exemption amount applies to an estate?

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

68. Which organization must apply for recognition of exemption?

A. A church operating an affiliated religious school
B. An integrated auxiliary of an established church
C. A convention of churches organized across several states

D. A charitable foundation formed to make educational grants

69. Which threshold determines whether an exempt organization may file the electronic notice?

A. Total assets below five hundred thousand dollars
B. Gross receipts below two hundred thousand dollars
C. Gross receipts normally at or below fifty thousand dollars
D. Any organization other than a private foundation

70. Which requirement applies to a savings incentive match plan?

A. The employer must maintain no more than five employees
B. The employer may also maintain another qualified plan
C. Contributions may follow a six-year graded vesting schedule
D. The employer must have one hundred or fewer employees

71. Which figure is used before applying the converted rate for a self-employed contribution?

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

72. Which livestock qualifies for Section 1231 treatment after twelve months?

A. Cattle held for breeding purposes on the farm
B. Breeding hogs held in the farmer's herd
C. Horses held for racing and showing purposes
D. Poultry raised for eventual sale to processors

73. Which farm election defers income to the following taxable year?

A. An election to average farm income across four years
B. An election to expense soil conservation expenditures
C. A crop insurance deferral where income normally follows
D. An election to use the accrual method for farming

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

A. A short-term operation where average customer use is six days
B. A twelve-month residential lease to a single tenant
C. A ground lease of undeveloped land for twenty years
D. A commercial lease with annual renewal options available

75. Which expense is deducted last against rental income under the vacation home limitation?

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

76. Which trust classification is determined annually rather than by the instrument?

A. Whether the trust is foreign or domestic for tax purposes
B. Whether the trust is simple or complex for the year
C. Whether the trust is a grantor trust under the powers held
D. Whether the trust is exempt from tax as a charitable entity

77. Which item is added back in computing distributable net income?

A. Capital gains allocated to corpus during the year
B. The personal exemption claimed by the entity
C. Expenses allocable to tax-exempt income received
D. Depreciation apportioned to the income beneficiaries

78. Which beneficiary absorbs distributable net income first?

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

79. Which expense of a trust survived the suspension of miscellaneous itemized deductions?

A. Fiduciary fees that would not arise but for the trust
B. Investment advisory fees of a kind individuals commonly pay
C. Custodial charges on a conventional brokerage account
D. Costs of managing rental property held for investment

80. Which condition triggers a trust's obligation to file Form 1041?

A. Distribution of any amount to a beneficiary during the year
B. Ownership of assets exceeding six hundred dollars in value
C. Existence of more than one beneficiary under the instrument
D. Any taxable income for the year, whatever the gross amount

81. Which test examines what an exempt organization actually does?

A. The organizational test applied to the governing document
B. The public support test applied to sources of funding
C. The commensurate test applied to program expenditures

D. The operational test requiring primarily exempt activity

82. Which conduct is absolutely prohibited for a charitable exempt organization?

A. Conducting an unrelated trade or business for profit
B. Participating in a political campaign for a candidate
C. Attempting to influence legislation to a limited degree
D. Accumulating income rather than granting it currently

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

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

84. Which passive income loses its exclusion from unrelated business taxable income?

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

85. Which vesting rule applies to employee elective deferrals?

A. Immediate and full vesting in every qualified plan
B. Three-year cliff vesting matching employer contributions
C. Six-year graded vesting matching employer contributions
D. Vesting only upon attainment of normal retirement age

86. Which arrangement is a prohibited transaction with a retirement plan?

A. Investing plan assets in publicly traded equity securities
B. Lending plan assets to the employer sponsoring the plan
C. Paying reasonable fees to an independent plan administrator
D. Making employer contributions within the deduction limits

87. Which farm expenditure is limited to twenty-five percent of gross farm income?

A. Prepaid feed and seed acquired before the growing season
B. Wages paid to seasonal agricultural laborers during harvest
C. Depreciation on machinery used in field operations
D. Soil and water conservation expenditures on the farmland

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

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

89. Which requirement must a real estate professional meet beyond the hours test?

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

90. Which item is rental income when received by a landlord?

A. Advance rent covering a period in a later taxable year
B. A refundable security deposit held pending lease expiry
C. A tenant improvement funded by the tenant for its own use
D. The landlord's own expenditure on property maintenance

91. Which dwelling use makes a property a residence under the vacation home rules?

A. Personal use of exactly fourteen days during the year
B. Personal use exceeding the greater of fourteen days or ten percent of rental days
C. Any personal use whatever during the taxable year
D. Personal use exceeding half the days the property was rented

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

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

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

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

94. Which condition permits an S corporation to file an amended return with corrected statements?

A. Approval of the correction by a majority of shareholders
B. Written permission obtained from the Service in advance
C. The correction must reduce rather than increase income

D. S corporations may amend; the restriction reaches partnerships

95. Which figure limits the deduction for business interest where the exemption does not apply?

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

96. Which deduction is available to an owner but computed outside the business schedule?

A. Wages paid to employees of the business during the year
B. Rent paid for premises used in the business operations
C. The owner's own retirement plan contribution amount
D. Insurance premiums covering business property and liability

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

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

98. Which loss limitation is applied last in the sequence for an individual?

A. The basis limitation on the owner's interest in the entity
B. The at-risk limitation excluding nonrecourse financing
C. The passive activity limitation on nonparticipating owners
D. The excess business loss limitation applying in aggregate

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

A. It is amortized over fifteen years regardless of actual life
B. It is amortized over its stated contractual term where shorter
C. It is deducted in full in the year it is acquired
D. It is recovered only upon disposition of the business

100. Which requirement applies where an exempt organization conducts several unrelated businesses?

A. The activities are combined into a single computation
B. Each activity is computed separately without cross-offsetting
C. Only the most profitable activity need be reported at all
D. Losses may offset the organization's exempt function income

Practice Exam 8: Answer Key and Explanations

1. D — Mere co-ownership of property does not create a partnership. The distinction turns on whether services are provided to occupants and whether the parties conduct a business rather than hold an investment. Dividing rent, holding land for appreciation, and occasional sales all fall on the co-ownership side of that line. Occasional joint sales likewise fall short of a business.

2. B — A business organized under a state incorporation statute is a per se corporation and cannot elect partnership or disregarded classification. Its only classification-related choice is whether to elect S status. Accounting method and taxable year elections are separate matters entirely and remain available on ordinary terms. Accounting method and tax year remain freely elected.

3. C — A domestic eligible entity with one member is disregarded by default, so its income and deductions flow directly onto the member's return exactly as a sole proprietorship would. The company still supplies state-law liability protection; it simply changes nothing federally unless an affirmative classification election is filed. Liability protection survives the disregarded federal treatment.

4. A — A fifty-two or fifty-three week year always ends on the same day of the week, which suits businesses whose operations run on weekly cycles and whose inventory counts are easier on a fixed weekday. Adoption requires no permission where the entity is otherwise permitted to use that year. Inventory counts on a fixed weekday drive the choice.

5. A — The hierarchy runs majority interest year first, then the year of all principal partners owning five percent or more, then least aggregate deferral. Each step is reached only when the preceding one produces no answer, so the computation is performed last rather than first in the analysis. Each step yields to the next only on producing no answer.

6. B — Activities consisting primarily of breeding, training, showing, or racing horses use the relaxed two-of-seven test. All other activities use three profitable years out of five consecutive years ending with the year in question, and Form 5213 may postpone the determination until the presumption period has run. Form 5213 postpones the determination for a new activity.

7. D — Bartered goods and services are included at the fair market value of what was received, so a contractor accepting accounting services for renovation work has income equal to the value of those services. Capital contributions, loan proceeds, and personal transfers increase the bank balance without producing income. Value received rather than cash paid measures the income.

8. C — The partnership takes a carryover basis equal to the contributor's adjusted basis immediately before the contribution, and the partner separately takes a substituted basis in the interest received. Fair market value plays no role in either computation, and the appreciation is preserved rather than recognized on transfer. Holding periods tack for capital and Section 1231 assets.

9. C — Initial outside basis equals money contributed, plus the adjusted basis of property contributed, plus the partner's share of partnership liabilities, less any liabilities of the partner assumed by the partnership. A purchased interest takes a cost basis, and an inherited interest takes fair market value at death. Liabilities the partnership assumes reduce that figure.

10. B — Losses exceeding outside basis are suspended and carried forward indefinitely until the partner restores basis by contribution, income allocation, or an increased share of liabilities. Only the excess is suspended; the amount within basis remains deductible subject to the at-risk and passive activity hurdles that follow. Restoration releases the suspended amount in a later year.

11. A — The partnership deducts guaranteed payments where the underlying expense is otherwise deductible, or capitalizes them where the services relate to a capital expenditure. Distributions, allocations, and returns of capital are not deductible at all, being movements of the partners' own equity rather than business expenses. Capitalization applies where services relate to capital items.

12. D — Section 704(c) preserves precontribution appreciation for the contributor. Where the contributed property is distributed to a different partner within seven years, the contributor generally recognizes the remaining built-in gain, preventing the shifting that a distribution would otherwise accomplish between partners in the same firm. Ordinary allocation on sale operates under the same provision.

13. A — A limited partner's distributive share is generally excluded from self-employment income, while a general partner's share of trade or business income is included. Guaranteed payments for services remain subject to the tax for either type of partner, which is the asymmetry these questions are built to test. A general partner includes the whole distributive share.

14. D — Termination now occurs only where no part of any business, financial operation, or venture continues to be carried on by any partner in a partnership. Technical termination on a fifty percent transfer has been repealed, so ownership changes alone no longer end the partnership's taxable year. Ownership changes alone no longer end the taxable year.

15. B — Abandonment ordinarily produces an ordinary loss because it is not a sale or exchange. Relief from even a small share of partnership liabilities converts the transaction into a deemed sale or exchange, making the loss capital. Questions in this area invariably turn on whether the partnership had liabilities outstanding. A single dollar of debt relief is sufficient to convert it.

16. C — The partnership must notify each partner of the election within thirty days of making it, and the election itself is made annually on a timely filed return. Eligibility requires one hundred or fewer Schedules K-1 and that every partner be an eligible type, both conditions holding simultaneously. One hundred or fewer statements is a separate condition.

17. B — Partners receiving push-out statements compute and pay the additional tax on their own returns with interest at two percentage points above the ordinary underpayment rate. The trade-off is that liability falls on the partners who actually benefited from the reviewed-year position rather than on current partners. Reviewed-year partners rather than current partners bear it.

18. C — A person transferring both property and services counts as a transferor with respect to all shares received, provided the property is not of relatively small value compared with the stock received for services. Published guidance treats property worth at least ten percent of that stock as sufficient for this purpose.

19. A — Only genuine stock in the transferee corporation escapes boot treatment. Corporate debt securities and nonqualified preferred stock carrying debt-like features are both boot despite appearances, as is cash. Receiving boot triggers gain equal to the lesser of realized gain or the boot, while loss is never recognized. Loss is never recognized regardless of boot received.

20. D — A parent-subsidiary group requires ownership of at least eighty percent of total combined voting power or at least eighty percent of total value, a disjunctive test contrasting with the conjunctive two-pronged control test governing Section 351. The chain may extend through multiple tiers tested at the same threshold. Multiple tiers are tested at the same eighty percent level.

21. A — Death benefits received on a key employee policy, net of cash surrender value, increase earnings and profits despite being excluded from taxable income. Federal income taxes, fines, and nondeductible life insurance premiums are all genuine outlays reducing the corporation's economic capacity to make distributions to shareholders. Cash surrender value is netted against the proceeds received.

22. C — The three tiers run dividend to the extent of earnings and profits, then tax-free return of capital reducing stock basis, then capital gain once basis is exhausted. Only the second tier reduces basis, and the third arises only after basis has already been driven to zero. Only the second tier reduces the shareholder's stock basis.

23. D — Both tests must be satisfied: five or fewer individuals owning more than half the stock during the last half of the year, and at least sixty percent of adjusted ordinary gross income being passive. The tax is self-assessing and mutually exclusive with the accumulated earnings tax for the same year.

24. B — Qualified subchapter S trusts and electing small business trusts exist to hold S corporation stock without defeating the election, alongside grantor trusts, voting trusts, and certain testamentary trusts. Foreign trusts, trusts with ineligible beneficiaries, and charitable remainder trusts generally do not qualify as permitted shareholders. Grantor and voting trusts also qualify as permitted holders.

25. A — Basis increases first for contributions and income, then decreases for distributions, then for nondeductible noncapital expenses, and finally for losses and deductions. Distributions precede losses so that cash received is not rendered taxable by a loss the shareholder may ultimately be unable to deduct at all. An election may reverse the final two steps of the order.

26. C — Losses are deductible to the extent of stock basis plus debt basis, and debt basis arises only from a direct loan from the shareholder to the corporation. Corporate borrowing from third parties, personal guarantees, and pledges of collateral all produce nothing until the shareholder actually pays under the obligation. Payment under a guarantee creates basis only when made.

27. B — Tax-exempt income does not increase the account and its related expenses do not decrease it, though both items affect stock basis. The account tracks income already taxed to shareholders once. Distributions reduce it only as far as zero, while losses may drive the balance negative in a poor year. The account records income already taxed to shareholders.

28. D — Both conditions are required: passive investment income exceeding twenty-five percent of gross receipts for three consecutive years, and accumulated earnings and profits carried over from C corporation years. A corporation that has always been an S corporation may hold entirely passive investments without any exposure at all. Three consecutive years above the threshold are required.

29. D — The accrual method is required where average annual gross receipts exceed the applicable threshold. That same test governs exemption from the uniform capitalization rules and from inventory accounting, so a taxpayer crossing it generally becomes subject to all three regimes at once rather than to only one. Crossing the threshold engages all three regimes together.

30. B — Merchandise removed for personal use must be subtracted from purchases. Treating it as a business expense or ignoring it entirely overstates cost of goods sold and understates gross profit by the same amount. Freight is added to inventoriable cost, and trade discounts reduce the invoice price directly. The withdrawal is a personal item rather than a cost.

31. C — A taxpayer meeting the gross receipts test is exempt entirely, which removes the rules from the great majority of small business returns. Producers and resellers are otherwise subject, and simplified production and resale methods exist for those who must comply but cannot trace every indirect cost precisely. Simplified production and resale methods aid compliance.

32. A — Nonrecourse financing carries no personal liability and is excluded from amounts at risk, though it does increase basis under the liability rules. Qualified nonrecourse financing secured by real property is the narrow exception, available only to real property activities rather than equipment or other ventures. Real property activities alone enjoy that narrow exception.

33. A — A purchase price reduction agreed between the original seller and a solvent buyer not in bankruptcy is treated as a basis adjustment rather than income. Debt cancelled as a gift, or forgiveness of an amount that would have been deductible if paid, likewise produces no cancellation income. Gratuitous discharge alone reaches the statutory exclusions.

34. C — 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 basis first, preserving a currently usable loss at the cost of future depreciation. The reduction equals the amount excluded, not forgiven.

35. B — In an S corporation the danger runs toward compensation that is too low, since the distributive share escapes self-employment tax while wages do not. The Service recharacterizes distributions as wages, assessing employment taxes plus penalties. In a C corporation the risk reverses toward excessive amounts becoming dividends. Penalties and interest accompany the recharacterization.

36. D — A spouse employed by a sole proprietorship is exempt from unemployment tax while remaining subject to Social Security and Medicare. A child under twenty-one enjoys the same unemployment exemption, and under eighteen is additionally exempt from Social Security. Incorporating the business destroys every one of these exemptions. Incorporating the business destroys every such exemption.

37. D — Rent is deductible for property the taxpayer does not own and in which no equity interest is held. Arrangements where title passes automatically, a nominal option exists, or payments materially exceed fair rental value are recharacterized as conditional sales producing depreciation and interest rather than rent deductions. Recharacterized leases yield depreciation and interest instead.

38. B — Where a domestic trip is primarily personal, transportation to and from the destination is entirely nondeductible, but expenses at the destination directly attributable to business remain deductible. Where the trip is primarily for business, transportation becomes fully deductible regardless of some personal time being taken. Primarily business trips make transportation fully deductible.

39. C — Meals treated as compensation and included in an employee's wages remain fully deductible, as do meals sold to customers and meals at company-wide recreational events. Meals furnished on the premises for the employer's convenience are subject to the fifty percent limit rather than being fully deductible. Company-wide recreational events also remain fully deductible.

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

41. C — The depreciable basis is the lower of adjusted basis or fair market value at conversion, preventing a taxpayer from converting a declined personal asset and depreciating a loss that was personal in character. Original adjusted basis is still used for computing gain on a later sale. Original adjusted basis still governs gain on later sale.

42. B — Nonresidential real property and residential rental property both use the mid-month convention regardless of when in the month they are placed in service, and both are always straight line. Personal property uses the half-year convention by default, replaced by mid-quarter where the fourth-quarter threshold is crossed. Both are always recovered on a straight line basis.

43. D — Qualifying property includes tangible personal property, off-the-shelf software, qualified improvement property, and roofs, heating, ventilation, fire protection, and security systems installed on nonresidential real property. Land is never depreciable, and the building structure itself remains outside the provision at thirty-nine years. Land is never depreciable under any circumstance. The structure itself remains at thirty-nine years.

44. A — Land improvements including fences, drainage tile, and wells carry a fifteen-year period, as does qualified improvement property. Machinery is typically five or seven years, office furniture is the seven-year default for property without a class life, and general farm buildings run twenty years instead. Qualified improvement property shares that fifteen-year period.

45. C — Section 1245 recaptures all depreciation allowed or allowable as ordinary income before any Section 1231 treatment is available. Real property follows the gentler Section 1250 rule recapturing only amounts claimed in excess of straight line, which under the current system is usually nothing at all. Straight line real property therefore recaptures nothing.

46. B — Section 1031 now reaches only real property held for productive use in a trade or business or for investment, and real property is broadly like kind to other real property. Equipment, livestock, and partnership interests are excluded in every circumstance under current law without exception. Improved may be exchanged for unimproved real property.

47. A — Reasonable compensation is wages rather than qualified business income and is excluded, as are guaranteed payments to partners on the same reasoning. Capital gains, dividends, investment interest, and foreign income are also excluded. Ordinary income from a domestic trade or business remains within the definition entirely. Guaranteed payments to partners are excluded on identical reasoning.

48. D — Engineering and architecture are conspicuously absent from the statutory list despite appearing in comparable provisions elsewhere. Both retain the deduction at any income level, subject only to the wage and property limitations. Consulting, accounting, and brokerage all appear on the list and lose it above the threshold. The wage and property limits still apply to them.

49. D — Losses arising after 2017 carry forward indefinitely with no carryback, except two years for farming losses. The deduction in any carryforward year is capped at eighty percent of taxable income computed without the loss deduction itself and without the qualified business income deduction being taken into account. Older pre-2018 losses carry no percentage limitation.

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

51. B — Federal income tax reduced book income and is never deductible for tax purposes, making it the largest addition on most corporate reconciliations. Tax-exempt interest, excess tax depreciation, and life insurance proceeds are all subtracted, being either nontaxable book income or tax deductions never recorded on the books. Book income that is not taxable is likewise subtracted.

52. C — The retained earnings analysis runs from the opening balance, adds book income and other increases, and subtracts distributions and other decreases to reach a closing balance that must tie to the balance sheet. A mismatch indicates a distribution recorded directly against equity or an undisclosed prior period adjustment. Prior period adjustments require separate disclosure.

53. D — A method requires consistent treatment across at least two consecutive returns. A single year's treatment is an error correctable by amendment. An impermissible method once adopted is changed only prospectively with consent, with the cumulative effect of all prior years brought forward as a Section 481(a) adjustment. Prospective change with consent is the only route available.

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

55. A — Liability categories are not informational. A partner's share of recourse, qualified nonrecourse, and other nonrecourse liabilities determines outside basis, which in turn determines loss deductibility, so an error in the allocation flows straight through to a wrong deduction on that partner's own return. Recourse and nonrecourse categories follow different rules.

56. B — Detailed instructions about when, where, and how to work are behavioral control indicators supporting employee status, along with training and evaluation directed at method rather than result. Market availability, unreimbursed investment, and genuine profit or loss opportunity all point toward independent contractor treatment instead. The right to control matters more than its exercise.

57. C — Relief requires reasonable basis, substantive consistency, and reporting consistency, all holding simultaneously. Failure to file information returns defeats the claim outright regardless of how reasonable the original basis was. Industry practice and a prior examination are both acceptable grounds for the reasonable basis element itself. All three conditions must hold at the same time.

58. B — Employment tax records must be kept four years after the tax becomes due or is paid, whichever is later. General records run three years from filing, extended to six where more than a quarter of gross income was omitted, and kept indefinitely where no return was filed at all. Property records run until the disposition year closes.

59. A — Commingled funds make every deduction harder to sustain because the burden of proving business purpose falls on the taxpayer and mixed accounts supply no evidence. Beyond tax, commingling is a principal ground on which state courts disregard an entity's separate existence and reach an owner's personal assets. Mixed accounts supply no evidence of business purpose.

60. D — A sole proprietor withdrawing cash has no tax event because the business and the individual are the same taxpayer. A partner's withdrawal reduces basis and may produce gain, a C corporation shareholder's is a dividend to the extent of earnings and profits, and an S corporation shareholder's follows four tiers.

61. B — A partner's share of entity liabilities increases outside basis whoever the lender is, which supports early loss deductions in a leveraged venture. An S corporation shareholder gains basis only from a direct loan, and C corporation losses trap at the entity level rather than reaching owners at all. C corporation losses never reach the owners at all.

62. A — The purchase price must be allocated across asset classes under a prescribed residual method, and both parties must report that allocation consistently. Buyers prefer asset purchases for stepped-up basis and fresh recovery periods, while sellers prefer entity sales producing capital gain rather than a mixture including ordinary recapture. Buyers and sellers prefer opposite transaction structures.

63. D — Recapture income is recognized in full in the year of sale even where the seller receives little or no cash that year, with only the remaining gain spread across the installment payments. A seller of heavily depreciated equipment can therefore owe substantial tax before collecting meaningful proceeds. Only remaining gain spreads across the payments received.

64. C — Full-time equivalents are computed by aggregating part-time hours and dividing by one hundred twenty, then added to actual full-time employees to determine applicable large employer status. Part-time employees count toward establishing status but are never owed an offer of coverage and never trigger a payment. Equivalents establish status but are owed no coverage.

65. C — A retained power to revoke is a triggering power making the trust a grantor trust, so income, deductions, and credits are reported directly by the grantor and the trust is disregarded. A revocable living trust therefore files no return during the grantor's life and becomes a separate entity at death.

66. B — Distributable net income caps the aggregate amount beneficiaries include, caps the trust's distribution deduction, and determines the character of what beneficiaries report. Amounts distributed in excess of it pass untaxed as distributions of corpus, with the tier system determining only who bears the taxable portion. Excess distributions pass untaxed as corpus to recipients.

67. A — An estate receives six hundred dollars, a simple trust three hundred, and a complex trust one hundred. These amounts are fixed by statute rather than indexed for inflation, which makes them among the very few figures in fiduciary taxation safely memorized without regard to the year being tested. These figures are never indexed for inflation.

68. D — Most organizations must apply for recognition, and filing within twenty-seven months of the end of the month of formation produces retroactive recognition. Churches, their integrated auxiliaries, and conventions or associations of churches are exempt from applying, though many apply anyway because donors expect the documentation. Donors and grantmakers generally expect the documentation.

69. C — The electronic notice serves organizations with gross receipts normally at or below fifty thousand dollars, measured on a three-year averaged basis. The short form requires receipts under two hundred thousand and assets under five hundred thousand, and private foundations file their own return whatever their size. Receipts are measured on a three-year averaged basis.

70. D — The plan is available to employers with no more than one hundred employees who maintain no other qualified plan. All contributions vest immediately rather than following any schedule, and the employer must either match dollar for dollar up to three percent or contribute two percent nonelectively for every eligible employee.

71. A — 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, resolving the circularity created because the contribution reduces the very base on which it is being computed. Twenty-five percent converts to twenty percent this way.

72. B — Cattle and horses require twenty-four months while other livestock held for draft, breeding, dairy, or sporting purposes require twelve, which covers hogs, sheep, and goats. Poultry is excluded by statute entirely, and animals held primarily for sale remain ordinary income property whatever the holding period. Poultry is excluded from the provision by statute.

73. C — A cash method farmer may defer crop insurance and disaster payments to the following year where income from the damaged crops would normally have been reported then. Weather-related livestock sales carry their own deferral, and farm income averaging spreads tax rather than deferring the recognition of income. Averaging spreads tax rather than deferring recognition.

74. 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 for material participation instead. This is why a materially participating short-term lodging operator may deduct losses that an identical long-term rental would trap as passive. Long-term rentals remain passive however much effort is spent.

75. D — The ordering places interest and taxes first, operating expenses second, and depreciation last, so depreciation is always the item disallowed where income runs out. That sequencing is favourable, since depreciation reduces basis only to the extent actually deducted and the disallowed amount carries forward. Disallowed depreciation carries forward to later years.

76. B — A trust is simple in a year where it distributes all income currently, makes no charitable contributions, and distributes no corpus; failing any condition makes it complex for that year. The classification is therefore annual, and the same trust may alternate between the two categories across successive years. A trust may alternate categories across successive years.

77. B — The computation adds back the distribution deduction and the personal exemption, subtracts capital gains allocable to corpus, and adds tax-exempt income net of allocable expenses. Corpus gains belong to the remainder beneficiary and are removed, producing a figure approximating income economically available for current distribution. Corpus gains belong to the remainder beneficiary instead.

78. C — 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 second-tier discretionary amount is taxed. Where the first tier exhausts the figure, discretionary beneficiaries receive their distributions entirely tax free as corpus. A trustee's failure to pay does not defer the tax.

79. A — Costs paid in connection with administering the entity that would not have been incurred if the property were not held in trust survived and remain fully deductible. Fiduciary fees, probate costs, and preparation fees for the entity's returns qualify, while ordinary investment advisory and custodial fees generally do not. Probate costs and return preparation fees also qualify.

80. D — The trust thresholds are disjunctive: any taxable income at all, or gross income of six hundred dollars or more, or any nonresident alien beneficiary. Meeting any single condition triggers the obligation, so a trust with modest gross income and one dollar of taxable income must nevertheless file a return. Estates instead use only the gross income threshold.

81. D — The operational test examines actual activities, requiring operation primarily for exempt purposes. The separate organizational test examines the governing document, which must limit purposes, avoid empowering substantial non-exempt activity, and permanently dedicate assets on dissolution. Both tests must be satisfied independently for exemption to be recognized. Both tests operate independently of one another.

82. B — Participation in any political campaign for or against a candidate for public office is absolutely prohibited and can result in revocation. Lobbying is permitted but may not be substantial, and unrelated business activity produces tax rather than revocation unless it becomes the organization's primary purpose entirely. An expenditure election may measure lobbying objectively.

83. A — Three elements must all be present: a trade or business, regularly carried on, and not substantially related to the exempt purpose other than through producing funds. A single annual fundraising event is not regularly carried on and escapes the tax whatever revenue it happens to generate. Producing funds alone never establishes substantial relation.

84. C — Debt-financed income is pulled into unrelated business taxable income in proportion to the outstanding acquisition indebtedness even where it would otherwise be excluded as passive. Rents attributable to personal property or measured by the tenant's profits also lose the exclusion under separate provisions. A mortgage is therefore the decisive fact in these items.

85. A — Employee elective deferrals vest immediately and fully in every plan, as do all contributions to simplified employee pensions and savings incentive match plans. Employer contributions to a qualified plan may instead follow a three-year cliff or six-year graded schedule, with top-heavy plans requiring accelerated vesting. Top-heavy plans require accelerated vesting beyond these.

86. B — The prohibited list covers sale, exchange, or leasing of property, lending money or extending credit, furnishing goods, services, or facilities, transferring plan assets to a disqualified person, and fiduciary self-dealing. The employer is itself a disqualified person, so lending plan assets to the sponsor is squarely prohibited. Fiduciary self-dealing is separately prohibited outright.

87. D — Soil and water conservation expenditures are deductible currently rather than capitalized, but only for land used in farming, only where consistent with an approved conservation plan, and only up to twenty-five percent of gross farm income, with the excess carried forward indefinitely to later years. An approved conservation plan is a further condition.

88. C — Weather-related sales of draft, breeding, and dairy animals may be treated as involuntary conversions with a four-year replacement period, extended further by published notice where drought persists across a region. Livestock held for sale instead qualifies for a one-year deferral of the excess proceeds received. Ordinary sale livestock receives a one-year deferral instead.

89. C — 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 during the year.

90. A — Advance rent is taxable when received regardless of accounting method and regardless of the period it covers, making this a rare instance where the accrual method does not defer. A refundable deposit is not income until applied to unpaid rent or retained to cover damage caused. Lease cancellation payments are likewise income when received.

91. B — 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. Use of exactly fourteen days does not exceed the threshold and leaves the property outside the limitation. Below the threshold a rental loss may still be claimed.

92. D — The Service allocates using total days of use, while some court decisions have permitted allocation across all days in the year, which leaves a larger share available as itemized deductions and produces a larger rental loss. Examination answers follow the Service method unless a question states otherwise. The two methods produce materially different loss figures.

93. B — Tax-exempt income does not increase the account and its related expenses do not reduce 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 loss year. Stock basis by contrast reflects both of those items.

94. D — A partnership subject to the centralized audit regime cannot amend and must file an administrative adjustment request instead. S corporations, and partnerships that have validly elected out, may file amended returns with corrected Schedules K-1 in the ordinary way without any special permission. Electing out requires both numerical and eligibility conditions.

95. A — The cap is the sum of business interest income, thirty percent of adjusted taxable income, and floor plan financing interest, with disallowed amounts carried forward indefinitely. A taxpayer meeting the gross receipts test governing accrual accounting and capitalization is exempt from the limitation entirely. Floor plan financing interest is added to the cap.

96. C — The owner's own contribution is an adjustment to income on the front of the return rather than a business schedule expense. Deducting it on the business schedule would reduce net earnings again and understate self-employment tax. Contributions made for employees are properly a business expense. Employee contributions are properly a business expense.

97. C — 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 runs for only two consecutive years and phases out as figures rise. The credit phases out as headcount or average wages rise.

98. D — The four hurdles run basis, at-risk, passive activity, then the excess business loss cap, each tested against the amount surviving the previous one. The disallowed excess at the final stage becomes a net operating loss carryforward rather than being permanently lost to the taxpayer. Basis, at-risk, passive, then the aggregate business loss cap.

99. A — Acquired intangibles are amortized ratably over fifteen years beginning with the month of acquisition, without regard to actual or contractual life, so a three-year covenant not to compete is still recovered over fifteen. No loss is recognized on disposing of one where others from the same acquisition are retained. Disallowed loss attaches to the retained intangibles' basis.

100. B — 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 same activity's future income, preventing profitable operations being sheltered behind unprofitable ones. Losses carry forward within their own activity silo.