PRACTICE EXAM 9: 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 consequence follows where an eligible entity files no classification election and has three domestic members?

A. It is disregarded as separate from its principal member
B. It becomes an association taxable as a corporation
C. It must obtain permission before filing any return
D. It is classified as a partnership under the default rule

2. Which period governs how far back a classification election may be made effective?

A. Twelve months before the date the form is filed
B. Thirty days before the date the form is filed
C. Seventy-five days before the date the form is filed
D. The first day of the year in which filing occurs

3. Which requirement applies to the responsible party named on an entity's application?

A. The party must be a natural person controlling the entity
B. The party must own a majority of the entity's equity
C. The party must reside in the entity's state of formation

D. The party must serve as an officer or director formally

4. Which entity is required to use a calendar tax year absent an established business purpose?

A. A partnership whose majority partner uses a fiscal year
B. A personal service corporation performing legal services
C. A C corporation with a June thirtieth accounting year
D. An estate administering property following a death

5. Which item does a partner add to outside basis alongside contributed property?

A. The fair market value of the interest received in exchange
B. The partnership's inside basis in all of its holdings
C. The projected value of future distributive share allocations
D. The partner's share of partnership liabilities assumed

6. Which condition makes a family member a recognized partner where capital is not a material income-producing factor?

A. Receipt of a capital interest by gift from a relative
B. Contribution of substantial services or genuine own capital
C. Attainment of the age of majority under state law
D. Written designation as a partner in the governing agreement

7. Which allocation of partnership items is respected without further inquiry?

A. One having substantial economic effect under the agreement
B. One agreed unanimously by all partners in writing
C. One matching each partner's relative capital contribution
D. One approved by the Service before the year begins

8. Which item must be allocated to the contributing partner under the built-in gain rules?

A. All ordinary business income of the partnership for the year
B. Depreciation on all partnership property placed in service
C. Precontribution appreciation when the property is sold
D. The partner's share of partnership recourse liabilities

9. Which distribution permits a partner to recognize a loss?

A. A current distribution of cash exceeding outside basis
B. A liquidating distribution of cash and inventory only
C. A liquidating distribution including a parcel of land
D. A current distribution of appreciated business equipment

10. Which item is a hot asset for purposes of characterizing gain on a sale of a partnership interest?

A. Cash held in the partnership's operating bank accounts
B. Marketable securities held for long-term investment
C. Land held by the partnership for capital appreciation
D. Depreciation recapture potential in partnership equipment

11. Which condition terminates a partnership under current law?

A. No part of any business continues in partnership form
B. Fifty percent or more of the interests change hands
C. The partnership disposes of substantially all its assets
D. The partnership agreement reaches its stated expiry date

12. Where are the exclusions for cancellation of partnership debt applied?

A. At the partnership level before any allocation occurs
B. At whichever level produces the smaller taxable amount
C. At the partner level on each partner's own circumstances
D. At the partnership level for bankruptcy only

13. Which requirement must a partnership satisfy to elect out of the centralized audit regime?

A. It must have been in existence for three or more years
B. It must obtain advance written consent from the Service
C. It must have fifty or fewer partners for the taxable year
D. Every partner must be an eligible type of person

14. Which figure does a partnership pay where no push-out election is made?

A. The aggregate additional tax computed on partner returns
B. A penalty determined by the number of partners involved
C. An imputed underpayment computed at the highest rate
D. Nothing, because partnerships never bear entity-level tax

15. Which shareholder group must satisfy the control test in a Section 351 exchange?

A. The persons transferring property, taken as a group
B. Each individual transferor considered separately
C. All shareholders of the corporation after the exchange
D. Only shareholders holding voting stock in the corporation

16. Which item does a corporation add to its carryover basis in property received?

A. The fair market value of the stock it issued in exchange
B. Any gain recognized by the transferring shareholder
C. The shareholder's substituted basis in the stock received

D. Any liabilities the shareholder retained on the property

17. Which liability treatment applies where a shareholder borrows against property days before transferring it and keeps the proceeds?

A. The entire liability is treated as boot received
B. Only the excess over basis is recognized as gain
C. The liability reduces stock basis with no gain arising
D. The transaction fails Section 351 in its entirety

18. Which figure limits a corporation's charitable contribution deduction?

A. Fifty percent of adjusted gross income for the year
B. Twenty-five percent of gross receipts from operations
C. The amount actually paid during the taxable year
D. Ten percent of taxable income computed before it

19. Which item reduces earnings and profits without producing any deduction?

A. The dividends received deduction claimed for the year
B. Tax-exempt interest received on municipal obligations
C. Nondeductible fines paid to a regulatory authority
D. Life insurance proceeds received on a key employee

20. Which distribution tier does not reduce a shareholder's stock basis?

A. The tax-free return of capital following the dividend tier
B. The dividend to the extent of earnings and profits
C. A distribution of appreciated property at fair market value
D. The capital gain arising after basis is exhausted

21. Which shareholder makes a corporation ineligible for S status?

A. An estate of a shareholder who died during the year
B. A resident alien holding permanent resident status
C. An electing small business trust that has elected
D. A nonresident alien holding a single share of stock

22. Which stock difference creates a second class defeating an S election?

A. A difference in voting rights between two share classes
B. A difference in transfer restrictions imposed by agreement
C. A difference in rights to distribution and liquidation proceeds
D. A difference in the certificate numbering used by the issuer

23. Which item does a shareholder use to establish debt basis in an S corporation?

A. A guarantee of a bank loan made to the corporation
B. A direct loan of funds to the corporation by the holder
C. Corporate borrowing from an unrelated commercial lender
D. Personal assets pledged as collateral for corporate debt

24. Which distribution ordering applies to an S corporation with no accumulated earnings and profits?

A. Tax free within stock basis, then capital gain on the excess
B. Dividend to the extent of current earnings, then basis
C. Accumulated adjustments account, then dividend, then basis
D. Return of capital first, then ordinary dividend treatment

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

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

26. Which figure does an S corporation shareholder use before losses reduce debt basis?

A. The corporation's accumulated adjustments account balance
B. The shareholder's share of corporate third-party liabilities
C. The shareholder's stock basis, which absorbs losses first
D. The fair market value of the shareholder's stock holding

27. Which condition must hold for the built-in gains tax to reach a disposition?

A. The corporation must have distributed the asset to a holder
B. The disposition must occur within the recognition period
C. The corporation must have more than one hundred shareholders
D. The asset must have been acquired after the S election

28. Which item does not reduce the accumulated adjustments account?

A. Ordinary losses allocated to shareholders for the year
B. Nondeductible noncapital expenses allocated on the K-1
C. Distributions that would drive the balance below zero
D. Separately stated deductions passed through to holders

29. Which taxpayer may not use the cash method of accounting?

A. A tax shelter regardless of its gross receipts level
B. A personal service corporation performing legal work
C. A service business without inventories or receipts

D. A farming corporation with modest annual receipts

30. Which item is subtracted separately to reach net sales from gross receipts?

A. Cost of goods sold computed from the inventory rollforward
B. Operating expenses incurred during the taxable year
C. Merchandise withdrawn by the owner for personal use
D. Returns and allowances credited to customers during the year

31. Which requirement accompanies an election of the last-in, first-out inventory method?

A. Use of the method in reports to creditors and owners
B. Annual renewal of the election on each timely return
C. Combination with lower of cost or market valuation
D. Application only to goods acquired after the election year

32. Which cost must a producer capitalize into inventory?

A. Advertising expenditures promoting the finished product
B. Quality control and inspection during the production process
C. Research and experimental costs for developing new items
D. Distribution of completed goods to purchasing customers

33. Which financing is treated as at risk despite carrying no personal liability?

A. Vendor financing arranged to purchase manufacturing equipment
B. Seller financing provided by the transferor of machinery
C. A nonrecourse loan from a partner to the partnership
D. Qualified nonrecourse financing secured by real property

34. Which discharge of debt produces no cancellation income?

A. A creditor forgiving a trade payable owed by a solvent firm
B. A seller reducing the price under seller financing
C. A supplier writing off a balance owed by a customer
D. A lender reducing principal on an operating credit line

35. Which attribute must a taxpayer reduce first after excluding cancellation income?

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

36. Which risk attends understated compensation in an S corporation?

A. The election terminates for failure to pay reasonable wages
B. The corporation loses its deduction for all distributions
C. Distributions are recharacterized as wages bearing payroll tax
D. The excess becomes a nondeductible constructive dividend

37. Which family employment arrangement escapes Social Security and Medicare tax?

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

38. Which travel cost is deductible where a domestic trip is primarily for business?

A. Personal sightseeing undertaken during free afternoons
B. Meals for accompanying family members during the trip
C. Round-trip transportation to and from the destination
D. Lodging for days devoted entirely to personal activity

39. Which expense produces no deduction whatever under current law?

A. Business meals with a client at a restaurant
B. Meals treated as compensation and included in wages
C. Meals provided at a company-wide recreational event
D. Entertainment such as tickets to a sporting event

40. Which condition converts an accountable plan into a nonaccountable one?

A. Permitting employees to retain unspent travel advances
B. Reimbursing employees more than once each calendar month
C. Requiring receipts for expenditures below a stated amount
D. Reimbursing meals at the fifty percent deductible rate

41. Which figure caps the Section 179 deduction beyond its dollar limits?

A. Gross receipts of the business for the taxable year
B. The taxpayer's adjusted gross income before the deduction
C. The total basis of all property placed in service
D. Aggregate taxable income from active trades or businesses

42. Which property is recovered over twenty-seven and a half years?

A. Residential rental property acquired for letting to tenants
B. Nonresidential real property used in a trade or business
C. Land improvements such as fencing and drainage tile

D. Qualified improvement property in a commercial building

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

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

44. Which deadline governs closing a deferred like-kind exchange?

A. Forty-five days from transferring the relinquished property
B. Ninety days from the closing of the relinquished sale
C. One hundred eighty days or the return due date, whichever is earlier
D. One year from the transfer of the relinquished property

45. 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. Guaranteed payments received by a partner for services
D. Section 179 expense allocated on a Schedule K-1

46. Which figure is used in the property limb of the wage and property limitation?

A. The adjusted basis of qualified property at year end
B. The fair market value of qualified property at acquisition
C. The depreciation claimed on qualified property to date
D. The unadjusted basis immediately after acquisition

47. Which taxpayer may claim the qualified business income deduction?

A. A C corporation conducting domestic manufacturing
B. An estate reporting income from an operating business
C. An employee reporting wages from a single employer
D. A nonresident alien with no United States business

48. Which carryover applies to a net operating loss arising after 2017?

A. Indefinite carryforward with no carryback except for farming
B. Two-year carryback and twenty-year carryforward as before
C. Five-year carryback available to corporations only
D. Twenty-year carryforward expiring if not fully absorbed

49. Which difference between book and taxable income never reverses?

A. Federal income tax expense recorded on the corporate books
B. Accelerated depreciation exceeding the book depreciation figure
C. Warranty reserves accrued for financial reporting purposes
D. An allowance for doubtful accounts recorded for book purposes

50. Which schedule reports the analysis of unappropriated retained earnings?

A. Schedule L, presenting beginning and ending balance sheets
B. Schedule M-2, which must tie to the balance sheet equity
C. Schedule M-1, reconciling book income to taxable income
D. Schedule G, identifying substantial stock ownership

51. Which technique tests whether a business return reports complete receipts?

A. Verifying that the balance sheet columns foot correctly
B. Reconciling depreciation to the detailed fixed asset ledger
C. Confirming retained earnings ties to the prior year figure
D. Comparing business-source deposits to reported gross receipts

52. Which treatment applies to a positive Section 481(a) adjustment?

A. Recognition entirely in the year the change occurs
B. Recognition over the remaining life of the affected assets
C. Recognition ratably over four years from the change year
D. Recognition only when the related property is disposed of

53. Which entity must file the more detailed reconciliation schedule?

A. Any corporation electing 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

54. Which figure appears on a partnership Schedule K-1 and directly determines loss deductibility?

A. The partnership's gross receipts for the taxable year
B. The identity of the designated partnership representative
C. The partner's share of liabilities reported by category
D. The partnership's total assets at the close of the year

55. Which factor points toward independent contractor status?

A. The business provides training in its preferred methods
B. The worker can realize a profit or suffer a genuine loss
C. The business supplies detailed instructions on work sequence

D. The worker receives a regular wage at fixed intervals

56. Which condition defeats statutory relief from worker reclassification liability?

A. Failure to file required information returns for the workers
B. Reliance on a long-standing practice in a significant industry segment
C. Reliance on a prior examination that raised no classification issue
D. Reliance on published judicial precedent covering similar workers

57. Which deposit rule overrides an employer's ordinary schedule?

A. Any liability arising in the final month of a quarter
B. A payroll exceeding five hundred employees in a period
C. Accumulated liability reaching one hundred thousand dollars
D. Any liability where the employer files annually rather than quarterly

58. Which record must be retained beyond the ordinary three-year period?

A. Copies of information returns furnished to contractors
B. Bank statements supporting deposits made during the year
C. Payroll registers for employees who have since departed
D. Records establishing the basis of business property held

59. Which entity form allows entity-level debt to support an owner's loss deduction?

A. A partnership, where liabilities increase each partner's basis
B. An S corporation, where guarantees establish shareholder basis
C. A C corporation, where losses flow through to shareholders
D. A sole proprietorship, where the owner is personally liable

60. Which item must both buyer and seller report consistently on a business asset sale?

A. The employment status of workers transferring with the business
B. The allocation of purchase price across the asset classes
C. The accounting method the buyer intends to adopt afterward
D. The seller's remaining net operating loss carryforwards

61. Which figure determines applicable large employer status?

A. Full-time employees counted on the final day of the year
B. Total employees appearing on the payroll at any point
C. Full-time employees plus equivalents in the preceding year
D. Full-time employees averaged across the current year

62. Which trust is disregarded for federal income tax purposes?

A. A grantor trust where the grantor retained a power to revoke
B. A complex trust accumulating income at trustee discretion
C. A simple trust distributing all its income currently
D. An electing small business trust holding corporate shares

63. Which item is subtracted in computing distributable net income?

A. The personal exemption allowed to the fiduciary entity
B. Tax-exempt income net of its allocable expenses
C. The distribution deduction claimed for amounts paid out
D. Capital gains allocable to corpus for the taxable year

64. Which beneficiary is taxed before any discretionary distribution is taxed?

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

65. Which exemption amount applies to a complex trust?

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

66. Which condition must an organization satisfy under the organizational test?

A. It must operate primarily for exempt purposes in practice
B. It must distribute a minimum proportion of assets annually
C. Its governing document must limit purposes and dedicate assets
D. It must obtain a determination letter before commencing work

67. Which conduct results in automatic loss of exemption with no threshold?

A. Conducting an unrelated trade or business regularly
B. Any part of net earnings benefiting a private insider
C. Attempting to influence legislation to a modest extent
D. Accumulating income rather than granting it currently

68. Which passive income is nevertheless taxable to an exempt organization?

A. Rents from real property subject to acquisition indebtedness
B. Dividends received on marketable equity securities held
C. Interest earned on the organization's operating reserves

D. Royalties received under a trademark licensing arrangement

69. Which plan must generally be established by the first of October?

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

70. Which figure precedes the rate conversion in computing a self-employed plan contribution?

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

71. Which livestock requires a twenty-four month holding period for Section 1231 treatment?

A. Breeding hogs held in the farmer's productive herd
B. Sheep and goats held for breeding and wool production
C. Poultry raised for eventual sale to processing operations
D. Cattle and horses held for breeding or dairy purposes

72. Which farm deduction faces a fifty percent of other farm expenses limitation?

A. Soil and water conservation expenditures on farmland
B. Prepaid feed, seed, and fertilizer acquired in advance
C. Veterinary services provided to productive breeding stock
D. Depreciation on machinery used in field operations

73. Which activity is not a rental activity under the passive loss rules?

A. One where the average period of customer use is six days
B. A twelve-month residential lease to a single family tenant
C. A ground lease of undeveloped land running twenty years
D. A commercial lease carrying annual renewal options

74. Which requirement accompanies the twenty-five thousand dollar rental real estate allowance?

A. Material participation exceeding five hundred hours annually
B. Qualification as a real estate professional for the year
C. Active participation and at least ten percent ownership
D. Ownership of the property for more than twenty-four months

75. Which expense is deducted last where the vacation home limitation applies?

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

76. Which trust classification may change from one year to the next?

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

77. Which election permits a revocable trust to share an estate's fiscal year?

A. An election made by the beneficiaries on their own returns
B. An election made by the trustee alone within sixty days
C. An election taking effect automatically upon the grantor's death
D. A combining election made jointly by executor and trustee

78. Which condition requires a trust to file an income tax return?

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

79. Which fee remains deductible by a trust despite the suspension of miscellaneous deductions?

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

80. Which organization is presumed to be a private foundation?

A. Every charitable organization unless it establishes otherwise
B. Only an organization with a single substantial contributor
C. Only an organization that has failed to file annual returns
D. Only an organization making grants rather than running programs

81. Which excise tax applies to private foundations but not to public charities?

A. A tax on failure to distribute a minimum amount annually
B. A tax on income from unrelated business activities conducted
C. A tax on reasonable compensation paid to organization officers

D. A tax on contributions received from a single major donor

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

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

83. Which consequence follows three consecutive years of failing to file the annual return?

A. A per-day penalty accruing until the returns are filed
B. Conversion of the organization to private foundation status
C. A requirement to obtain a determination letter afresh
D. Automatic revocation of exemption by operation of law

84. Which contribution is permitted under a simplified employee pension?

A. Elective deferrals withheld from participating employee wages
B. Discretionary employer contributions under a written formula
C. Catch-up contributions by participants aged fifty and above
D. Matching contributions responding to employee deferrals

85. Which person is a disqualified person for prohibited transaction purposes?

A. Any participant with an account balance in the plan
B. Any beneficiary designated to receive benefits on death
C. Any vendor supplying goods to the employer's business
D. An owner of fifty percent or more of the sponsoring employer

86. Which consequence follows a prohibited transaction involving an individual retirement arrangement?

A. The entire account ceases to be an arrangement that year
B. An excise tax applies to the amount involved in the transaction
C. Contributions are suspended for the three following years
D. A penalty of ten percent of the account balance is imposed

87. Which farm expenditure requires consistency with an approved conservation plan?

A. Fertilizer applied to growing crops during the season
B. Prepaid feed acquired before the consumption season
C. Soil and water conservation expenditures on farmland
D. Repairs to machinery used in field operations

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. Four years, extendable where drought persists regionally
C. Three years, as with condemned business real property
D. One year, matching the ordinary deferral election period

89. Which taxpayer may elect farm income averaging?

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

90. Which condition must a real estate professional satisfy alongside the hours requirement?

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

91. Which disposition releases suspended passive losses in full?

A. A gift of the whole interest to an adult child of the owner
B. A fully taxable disposition of the entire interest to an unrelated party
C. A sale of half the interest to an unrelated purchaser
D. A transfer of the interest to a corporation the owner controls

92. Which item is rental income when the landlord receives it?

A. A refundable security deposit held pending lease expiry
B. A tenant improvement funded by the tenant for its own use
C. Expenses the tenant pays on the landlord's behalf
D. The landlord's own outlay on maintaining the property

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

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

94. Which method does the Service apply in allocating vacation home interest and taxes?

A. Allocation across all three hundred sixty-five days of the year

B. Allocation entirely to the rental use of the dwelling
C. Allocation by the relative fair rental value of each period
D. Allocation using the total days the property was actually used

95. 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. Gain recognized on distributing appreciated corporate property
D. Separately stated income items reported on the Schedule K-1

96. Which entity may file an amended return with corrected owner statements?

A. An S corporation correcting an error on a prior return
B. A partnership that has not elected out of the regime
C. A partnership with more than one hundred partners
D. A partnership subject to the centralized audit regime

97. Which figure caps the deduction for business interest where no exemption applies?

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

98. Where does a self-employed owner deduct their own retirement plan contribution?

A. On the business schedule as an ordinary operating expense
B. As an adjustment to income on the front of Form 1040
C. On Schedule SE before computing self-employment tax
D. As an itemized deduction on Schedule A of the return

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

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

100. Which statement about the sequence of loss limitations is correct?

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

Practice Exam 9: Answer Key and Explanations

1. D — A domestic eligible entity with two or more members defaults to partnership classification where no election is filed, and disregarded treatment reaches only single-member domestic entities. Corporate status requires an affirmative election on Form 8832, while S status additionally requires a timely Form 2553. Neither arises automatically on formation, and the default persists indefinitely until an election is actually made.

2. C — 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 day it is filed. All members must generally consent to the election, and a sixty-month limitation then restricts any further classification change except in defined circumstances.

3. A — The responsible party must be a natural person who actually controls or directs the entity and its assets, rather than another entity or a nominee, and must supply a personal taxpayer identification number. Applications are limited to one per responsible party each day, and a change in that person must be reported within sixty days on the prescribed form.

4. B — A personal service corporation is confined to a calendar year unless it establishes a business purpose for another, as is an S corporation. A Section 444 election permits deferral of no more than three months, but for a personal service corporation it carries a minimum distribution requirement limiting deductions for amounts paid to owner-employees where the requirement is unmet.

5. D — Initial outside basis equals money contributed, plus the adjusted basis of any property contributed, plus the partner's share of partnership liabilities, less any liabilities of the partner assumed by the partnership. Fair market value of the interest plays no role. A purchased interest takes a cost basis instead, and an inherited interest takes value at the date of death.

6. B — Where capital is not a material income-producing factor, as in a professional services firm deriving income from personal services, a gifted interest does not make the recipient a partner. Recognition requires the family member to contribute substantial services or capital genuinely originating with them. Where capital is material, a genuine gifted capital interest suffices for recognition.

7. A — An allocation stated in the partnership agreement is respected where it has substantial economic effect, or otherwise accords with the partners' interests in the partnership. An allocation shifting tax items without the corresponding economic benefit or burden is reallocated according to those true interests. Unanimity, proportionality to capital, and advance approval are none of them the operative test.

8. C — Section 704(c) requires income, gain, loss, and deduction with respect to contributed property to be allocated so as to account for the difference between basis and value at contribution. Precontribution appreciation therefore returns to the contributor on sale, and depreciation on the built-in gain is allocated away from that partner during the holding period instead.

9. B — Loss may be recognized only on a liquidating distribution and only where the partner receives nothing but money, unrealized receivables, and inventory. A single item of other property such as land or equipment absorbs the remaining basis and defeats recognition entirely. Cash exceeding basis in a current distribution produces gain rather than any deductible loss.

10. D — The definition of unrealized receivables is broader than the name suggests, capturing rights to payment not yet included in income and also depreciation recapture potential embedded in depreciable property. A partnership holding heavily depreciated equipment therefore carries hot assets even without conventional receivables, and the attributable portion of gain becomes ordinary income rather than capital gain.

11. A — 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 entirely, so ownership changes no longer close the tax year, restart depreciation, or require a short-period return to be filed.

12. C — Cancellation income flows through as a separately stated item and the bankruptcy, insolvency, and other exclusions are tested against each partner's own position. An insolvent partnership provides no relief to a solvent partner, and a solvent partnership may allocate excludable income to an insolvent partner who excludes it entirely. Identical allocations can therefore produce opposite results.

13. D — Electing out requires both that the partnership furnish one hundred or fewer Schedules K-1 and that every partner be an eligible type: an individual, C corporation, S corporation, foreign entity treated as a C corporation, or the estate of a deceased partner. A single trust, partnership, or disregarded entity partner defeats the election regardless of the partnership's size.

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

15. A — The transferors of property are treated as a group rather than individually, so a shareholder contributing a trivial amount of property still receives nonrecognition provided the group as a whole satisfies control. The corollary is that one person's failure contaminates the transaction for everyone, which is why a service provider's shares can defeat the entire exchange.

16. B — The corporation takes a carryover basis equal to the transferor's adjusted basis, increased by any gain that transferor recognized, which prevents the same gain being taxed a second time later. The shareholder separately takes a substituted basis in the stock equal to property basis less boot and liabilities assumed, plus the gain recognized on the exchange.

17. A — Where the principal purpose of the assumption is avoidance of federal income tax, or there is no bona fide business purpose for it, the entire amount of the liabilities assumed becomes boot rather than merely the excess over basis. Borrowing against unencumbered property shortly before transfer and pocketing the proceeds is the classic pattern triggering this harsher exception.

18. D — The limitation is ten percent of taxable income computed before the charitable deduction itself, before the dividends received deduction, and before any capital loss or net operating loss carryback. Excess contributions carry forward five years and are used after the current year's contributions. An accrual corporation may elect to deduct board-authorized amounts paid shortly after year end.

19. C — Nondeductible fines and penalties are genuine expenditures reducing the corporation's economic capacity to distribute, so they decrease earnings and profits despite producing no deduction. Tax-exempt interest, life insurance proceeds, and the dividends received deduction all move in the opposite direction and increase the measure, the first two as receipts and the third as a deduction without outflow.

20. B — Only the second tier, the tax-free return of capital, reduces stock basis. The dividend tier does not touch basis at all, and the third tier arises only once basis has already reached zero. Candidates frequently reduce basis by the entire distribution and report no capital gain, which produces a figure offered among the answer choices.

21. D — Nonresident aliens are ineligible shareholders, as are partnerships, corporations, and most trusts. Estates, resident aliens, and qualifying trusts including electing small business trusts and qualified subchapter S trusts are all permitted. Eligibility is continuous rather than tested once, so a shareholder becoming a nonresident alien terminates the election on the day the status changes.

22. C — The one class of stock requirement looks to identical rights in distribution and liquidation proceeds. Differences in voting rights are expressly permitted, which makes voting and nonvoting common the standard succession planning structure. Preferred stock carrying a priority dividend creates a second class and defeats the election immediately upon issuance to any holder.

23. B — Debt basis arises only from a direct loan creating genuine indebtedness running from the corporation to that shareholder, which requires an actual economic outlay. A guarantee, a pledge of personal collateral, and corporate borrowing from third parties all produce nothing until the shareholder actually pays under the obligation and becomes the corporation's creditor.

24. A — Where no accumulated earnings and profits exist there is no dividend tier at all. The distribution is tax free to the extent of the shareholder's stock basis, reducing that basis, and any excess becomes capital gain from a deemed sale of stock. Dividend treatment requires earnings and profits carried over from prior C corporation years.

25. D — Where the corporation ceases to satisfy any eligibility requirement the election terminates immediately on the date of the disqualifying event rather than at the beginning or end of a year. Issuing even one share to a partnership accomplishes this, and the year then splits into an S short year and a C short year requiring separate returns.

26. C — Losses reduce stock basis first and debt basis only afterward, while restoration in a later profitable year runs in the opposite direction, rebuilding debt basis before equity. This ordering protects the shareholder's loan ahead of the investment. Third-party corporate liabilities never enter the computation, since only a direct shareholder loan creates debt basis at all.

27. B — The tax reaches appreciation economically present at conversion and disposed of within a five-year recognition period beginning on the first day of the first S year. A disposition on the first day after that period closes escapes entirely, which is why examination fact patterns place sales a few months either side of the boundary date.

28. C — Distributions reduce the account only as far as zero and can never drive it negative, though losses and deductions can. Tax-exempt income neither increases the account nor do its related expenses reduce it, unlike stock basis where both items have effect. These two departures from basis mechanics are among the most reliably tested points here.

29. A — Tax shelters may never use the cash method whatever their size, while personal service corporations, service businesses without inventories, and farming corporations meeting the applicable conditions may all use it. The gross receipts test otherwise governs, and that same threshold determines exemption from inventory accounting and from the uniform capitalization rules.

30. D — Gross receipts are reported before any deduction whatever, and returns and allowances are subtracted separately to reach net sales, after which cost of goods sold produces gross profit. Merchandise withdrawn for personal use reduces purchases inside the cost of goods sold computation rather than reducing receipts, and operating expenses come later still.

31. A — The conformity requirement obliges a taxpayer electing the method for tax purposes to use it in reports to shareholders, partners, and creditors, preventing a taxpayer claiming the tax benefit while showing higher earnings to a lender. The election is made on the prescribed form and applies until the Service consents to a change of method.

32. B — Quality control, inspection, rework, spoilage, purchasing, handling, storage of unsold goods, production depreciation, and allocable overhead must all be capitalized. Advertising, research and experimentation, general administration unrelated to production, and distribution of goods to customers all remain currently deductible period costs falling outside the capitalization requirement entirely. Storage of unsold goods must nevertheless be capitalized.

33. D — Nonrecourse debt secured by real property, borrowed from a qualified commercial lender or a government entity and not convertible into equity, is treated as at risk despite the absence of personal liability. The exception exists only for real property activities, which is why real estate ventures generate deductible losses that identically financed equipment activities cannot.

34. B — A purchase price reduction agreed between the original seller and a solvent buyer not in bankruptcy is treated as an adjustment to basis rather than income. Debt cancelled as a gift, contributed to capital by a shareholder-creditor, or representing an amount that would have been deductible if paid likewise produces no cancellation income at all.

35. A — The prescribed order runs net operating losses, general business credit carryovers, the minimum tax credit, capital loss carryovers, basis of property, passive activity carryovers, and finally foreign tax credits. The reduction equals the amount excluded rather than the amount forgiven, and a taxpayer may elect to reduce depreciable property basis first instead.

36. C — Because a distributive share escapes self-employment tax while wages do not, an obvious incentive exists to understate salary. The Service recharacterizes distributions as wages, assessing employment taxes plus penalties and interest, though the election itself is not terminated. In a C corporation the risk reverses entirely toward excessive compensation becoming a nondeductible dividend.

37. B — A child under eighteen employed by a parent's sole proprietorship, or by a partnership in which every partner is a parent, is exempt from Social Security and Medicare tax and remains exempt from unemployment tax until age twenty-one. Spouses and parents are subject to Social Security while exempt from unemployment tax, and incorporating destroys all of these exemptions.

38. C — Where a domestic trip is primarily for business, transportation to and from the destination is fully deductible even though some personal time is taken. Expenses at the destination remain deductible only to the extent directly attributable to business. Where the trip is primarily personal, transportation becomes entirely nondeductible while business expenses at the destination survive.

39. D — Entertainment produces no deduction at all regardless of business purpose, which captures tickets, club dues, and recreational outings. Business meals remain fifty percent deductible where the taxpayer or an employee is present and the meal is not lavish. Food purchased at an entertainment event is fifty percent deductible only where separately stated on the invoice.

40. A — An accountable plan requires a business connection, substantiation within a reasonable period, and return of any excess advance. Allowing employees to keep unspent advances defeats the third condition, and failure of any single condition converts the entire arrangement for every participant. All payments then become taxable wages with no offsetting employee deduction available.

41. D — The deduction cannot exceed aggregate taxable income from the active conduct of any trade or business, so it can never create or increase a loss, and any disallowed amount carries forward indefinitely. Bonus depreciation carries no comparable income limitation and can generate a net operating loss usable against income from other sources.

42. A — Residential rental property carries a twenty-seven and a half year period while nonresidential real property runs thirty-nine years, both recovered straight line under the mid-month convention regardless of the placement date. Land improvements run fifteen years, as does qualified improvement property, which is additionally eligible for Section 179 expensing unlike the building structure itself.

43. B — Section 1245 recaptures all depreciation allowed or allowable as ordinary income before any Section 1231 treatment becomes available, so the ordinary component is the lesser of depreciation claimed or total gain. Real property follows the gentler Section 1250 rule recapturing only amounts claimed above straight line, which under current recovery methods is usually nothing.

44. C — 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 what was intended as an exchange into a fully taxable sale.

45. C — Guaranteed payments are excluded on the same reasoning that excludes S corporation reasonable compensation: both are payments for services rather than a share of business profits. Capital gains, dividends, investment interest, foreign income, and income from performing services as an employee are all likewise outside the definition of qualified business income.

46. D — Qualified property is measured at its unadjusted basis immediately after acquisition, meaning original cost without reduction for depreciation, for property still held and within its depreciable period at year end. The limb adds twenty-five percent of W-2 wages to two and a half percent of that figure, and the taxpayer claims whichever limb is larger.

47. B — The deduction is available to individuals and also to estates and trusts, which apply the threshold amounts at the entity level. C corporations have no need of it and cannot claim it, and income from performing services as an employee is expressly excluded, which makes worker classification a question with consequences well beyond payroll tax.

48. A — Losses arising after 2017 carry forward indefinitely with no carryback, except two years for farming losses, and the deduction in any year is capped at eighty percent of taxable income computed without the loss deduction and without the qualified business income deduction. Pre-2018 losses are used first and carry no percentage limitation at all.

49. A — Federal income tax reduces book income and is never deductible for tax, so the difference is permanent and changes the effective rate the corporation bears. Bad debt allowances, accelerated depreciation, and warranty reserves all reverse in later periods and are temporary differences affecting only when tax is paid rather than how much ultimately.

50. B — Schedule M-2 runs from the opening balance, adds net income per books and other increases, and subtracts distributions and other decreases to reach a closing figure that must agree with the equity section of Schedule L. For an S corporation it instead tracks the accumulated adjustments account and related balances governing distributions.

51. D — Removing documented non-income deposits such as loan proceeds and owner transfers, then comparing the remainder against reported receipts, exposes income that never reached the books. A cash rollforward that ties proves only that whatever was recorded was recorded consistently; it is no evidence at all that the record was complete in the first place.

52. C — 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. Candidates frequently apply the four-year spread symmetrically, which is wrong. The asymmetry deliberately encourages voluntary correction of impermissible methods rather than waiting for an examination to force one.

53. D — The threshold is total assets of ten million dollars or more, at which point the detailed schedule replaces the ordinary reconciliation. It requires each difference to be separated into permanent and temporary columns and the source of book income identified, supplying detail that aggregated single-line disclosures had concealed from examiners reviewing larger returns.

54. C — A partner's share of recourse, qualified nonrecourse, and other nonrecourse liabilities determines outside basis, which in turn determines how much loss may be deducted. These categories are therefore substantive rather than informational, and an error in the allocation flows straight through to a wrong deduction on that partner's own individual return.

55. B — Genuine opportunity for profit or loss is a financial control indicator pointing toward independence, along with significant unreimbursed investment, availability of services to the market generally, and payment by the project. Training, detailed instructions, and payment of a regular wage are all indicators pointing the other way toward an employment relationship instead.

56. A — Relief requires reasonable basis, substantive consistency, and reporting consistency, all holding at once. Failure to file information returns defeats the claim outright however reasonable the original basis was. Industry practice, a prior examination, and judicial precedent are each acceptable grounds for establishing the reasonable basis element rather than obstacles to relief.

57. C — Where accumulated liability reaches one hundred thousand dollars on any day, that amount must be deposited by the next business day, and a monthly depositor triggering the rule becomes a semiweekly depositor for the rest of that year and the following one. Otherwise the schedule is fixed by liability during the lookback period.

58. D — Basis records must survive as long as the asset does and then through the limitations period for the disposition year, which for real property can mean several decades. Employment tax records run four years, general records three years extended to six where a quarter of gross income was omitted, and indefinitely where no return was filed.

59. A — A partner's share of partnership liabilities increases outside basis whoever the lender happens to be. An S corporation shareholder gains basis only from a direct loan to the corporation, since a guarantee produces nothing until actually paid, and C corporation losses trap at the entity level and never reach shareholders at all.

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

61. C — Status is determined by the preceding calendar year, averaging full-time employees together with full-time equivalents. Full-time means thirty hours weekly or one hundred thirty monthly, and equivalents are aggregate part-time hours divided by one hundred twenty. Part-time employees count toward status but are never owed coverage and never enter the payment computation.

62. A — Where the grantor retains specified powers, including a power to revoke, the trust is disregarded and its income, deductions, and credits are reported directly by the grantor. A revocable living trust is therefore a grantor trust by definition, files no separate return during the grantor's life, and becomes a separate taxable entity only at death.

63. D — Capital gains allocable to corpus are subtracted because they belong to the remainder beneficiary rather than the income beneficiary. The distribution deduction and the personal exemption are both added back, and tax-exempt income net of allocable expenses is added, producing a figure that approximates the income economically available for current distribution to beneficiaries.

64. B — First-tier distributions are amounts of income required to be distributed currently, whether or not actually paid, and they absorb distributable net income before second-tier discretionary amounts are taxed at all. A trustee's failure to make the required payment does not defer the beneficiary's tax on the amount the instrument obliges the trust to distribute.

65. D — The exemption is one hundred dollars for a complex trust, three hundred for a simple trust required to distribute all income currently, and six hundred for an estate. These amounts are fixed by statute and are not indexed for inflation, making them among the few figures in fiduciary taxation safely memorized regardless of year.

66. C — The organizational test examines the governing document, which must limit purposes to exempt ones, must not expressly empower substantial non-exempt activities, and must permanently dedicate assets to an exempt purpose on dissolution. The separate operational test examines what the organization actually does, and both tests must be satisfied independently for exemption to be recognized.

67. B — 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 grows to become the organization's primary purpose over time. Primary purpose is the point at which tax becomes revocation.

68. A — 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 likewise lose the exclusion, making the presence of a mortgage the decisive fact in these questions.

69. C — The savings incentive match plan must generally be established by October first for the year it is to be effective, a deadline carrying no extension whatever. A simplified employee pension may instead be established and funded as late as the extended return due date, which makes it the only option available after year end.

70. 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, so twenty-five percent becomes twenty percent, which resolves the circularity created because the contribution itself reduces the very base on which it is computed.

71. D — Cattle and horses held for draft, breeding, dairy, or sporting purposes require twenty-four months, while other livestock including hogs, sheep, and goats require only twelve. Poultry is excluded from the provision by statute entirely, and animals held primarily for sale remain ordinary income property regardless of the holding period. Sale-held animals remain ordinary income property throughout.

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

73. A — An activity where the average period of customer use is seven days or less, or thirty days or less with significant personal services, is not a rental activity at all and is tested under ordinary material participation standards. This is why a materially participating short-term lodging operator may deduct losses a long-term landlord cannot.

74. C — Active participation is a materially lower standard than material participation, requiring only bona fide involvement in management decisions such as approving tenants, setting terms, and authorizing repairs, and it survives the use of a management company. The taxpayer must additionally own at least ten percent of the activity for the allowance to be available.

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

76. D — A trust is simple in a year where it distributes all income currently, makes no charitable contributions, and distributes no corpus, and failing any one condition makes it complex for that year alone. The classification is therefore tested annually rather than fixed by the instrument, so a trust may alternate between categories across successive years.

77. D — The election is made jointly by the executor and the trustee on the estate's first return and is irrevocable once made. It allows the trust to use the estate's fiscal year and its two-year exemption from estimated tax payments, which together are the principal procedural advantages estates hold over ordinary trusts.

78. B — The trust thresholds are disjunctive, so a return is required where the trust has any taxable income at all, or gross income of six hundred dollars or more, or any beneficiary who is a nonresident alien. Meeting a single condition triggers the obligation, and estates by contrast apply only the gross income test.

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

80. A — Every charitable organization is presumed to be a private foundation unless it establishes public charity status, either by functioning as a defined institution such as a church, school, or hospital, or by satisfying a public support test showing sufficient support from the general public rather than from a narrow group of donors.

81. A — Private foundations face excise taxes on net investment income, self-dealing with disqualified persons, failure to distribute a minimum amount, excess business holdings, jeopardizing investments, and taxable expenditures. Public charities face none of these, though both categories remain subject to the unrelated business income tax on qualifying activities they conduct. Both categories bear the unrelated business income tax alike.

82. C — 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 entirely, whatever revenue that event happens to generate for the organization.

83. D — Three consecutive years of non-filing revokes exemption automatically by operation of law, with no notice required and effect from the third year's due date. Reinstatement requires a fresh application and fee, and the rule catches the smallest organizations most often since those filing only the electronic notice frequently do not realise a filing is due.

84. B — Only the employer contributes, and contributions are discretionary from year to year under a written allocation formula. There are no elective deferrals, no matching, and no catch-up contributions of any kind. Coverage must extend to every employee meeting the age, service, and compensation conditions, and all contributions vest immediately upon deposit.

85. D — Disqualified persons include plan fiduciaries, the employer, employee organizations, owners of half or more of the employer, and members of their families. Ordinary participants, named beneficiaries, and unrelated vendors are all excluded. The prohibition reaches sales, leasing, lending, furnishing goods or services, and any self-dealing by a plan fiduciary. Family members of those persons are likewise disqualified.

86. 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 or repayment does not cure the disqualification once the transaction has occurred.

87. C — 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 any excess carried forward indefinitely to later years rather than being lost. The plan must be approved before the deduction is claimed.

88. B — 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 conditions persist across a region. Livestock held for sale rather than these purposes instead qualifies for a one-year deferral of the excess proceeds received.

89. D — Averaging is available only to individuals, which includes 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 within the limitations period.

90. A — 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. Licensure and ownership percentage are not part of the test.

91. B — Release requires disposing of the entire interest in the activity in a fully taxable transaction to an unrelated party, after which suspended losses become deductible against non-passive income. A gift, a partial disposition, or a transfer to a related party or controlled entity does not trigger any release of the trapped losses.

92. C — Expenses the tenant pays on the landlord's behalf are rental income, as are rents received, advance rent, lease cancellation payments, and the fair market value of property or services accepted instead of cash. A refundable deposit is not income until applied to unpaid rent or retained to cover damage caused.

93. C — 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. Use of exactly fourteen days does not exceed the threshold, leaving the property outside the limitation entirely.

94. D — The Service allocates using total days of use, while some court decisions have permitted allocation across all days in the year, leaving a larger share available as itemized deductions and producing a larger rental loss. Examination answers follow the Service method unless a particular question expressly directs otherwise on its facts.

95. B — Tax-exempt income does not increase the account and its related expenses do not reduce it, though both items affect stock basis. Ordinary income, separately stated income, and recognized gains all increase it. Distributions reduce it only as far as zero, while losses may drive the balance negative in an unprofitable year.

96. A — A partnership subject to the centralized regime cannot amend and must file an administrative adjustment request instead, with adjustments reaching partners through statements. An S corporation, or a partnership that has validly elected out of the regime, may file an amended return with corrected statements in the ordinary way without special procedure.

97. D — 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 that also governs accrual accounting, inventories, and capitalization is exempt from the limitation altogether. Disallowed amounts nevertheless carry forward indefinitely.

98. B — The owner's own contribution is an adjustment to income rather than a business schedule expense, because deducting it on the business schedule would reduce net earnings again and understate self-employment tax. Contributions made on behalf of employees are properly a business expense, so one plan produces deductions in two different places.

99. A — 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 headcount or average wages rise.

100. C — The four hurdles operate in a fixed sequence and each is tested against the amount that survived the previous one rather than against the original loss. Basis is tested first, then at-risk, then passive activity, then the excess business loss cap, whose disallowed remainder becomes a net operating loss carryforward to the following year.