PRACTICE EXAM 15: SEE PART 2 — BUSINESSES (100 QUESTIONS)

This full-length simulation exam contains 100 multiple-choice questions covering SEE Part 2: Businesses, built to mirror the domain weighting of the official IRS Special Enrollment Examination. The official Part 2 exam, administered by PSI Services LLC, consists of 85 scored questions (plus unscored pretest questions) with a 3.5-hour time limit; this practice exam is expanded to 100 questions per the book's practical question-count override so that the total practice question bank across all Part 2 exams reaches a useful study volume, while domain weighting percentages are scaled proportionally from the official 85-question breakdown. For the most realistic practice, allow yourself 3.5 hours to complete this exam without interruption, using only scratch paper and a basic calculator as permitted at the PSI test center. The IRS-published passing score is a scaled score of 500 or higher on a 200-800 scale. Mark your answer for each question, then check your work against the Answer Key and Explanations section that follows. For an interactive, timed practice experience, use the Online Exam Simulator included with this book.

1. Maria operates a small bakery as a sole proprietorship. A supplier sues the business for unpaid invoices and wins a judgment. Which statement correctly describes Maria's exposure to this judgment?

A. Maria's liability is limited to the assets titled in the bakery's business bank account.
B. Maria is not personally liable because the debt was incurred by the business entity.
C. Maria's liability is limited to her original capital contribution to the bakery.
D. Maria is personally liable for the debt because a sole proprietorship has no legal separation from its owner.

2. A self-employed consultant operating as a sole proprietor reports $80,000 of net profit for the year. How is this income reported and taxed for federal purposes?

A. It is reported on Form 1065 and taxed at the partnership's applicable federal rate.
B. It is reported on Schedule E and exempt from self-employment tax entirely.
C. It is reported on Schedule C and subject to both income tax and self-employment tax.
D. It is reported on Form 1120 and taxed once at the corporate level only.

3. A new partner receives a 10% interest in future partnership profits solely in exchange for services to be performed for the partnership, with no interest in existing partnership capital. Assuming the safe harbor conditions are met, how is this receipt generally treated for the partner?

A. It is taxable immediately at the fair market value of the partnership's existing assets.
B. It is generally not a taxable event upon receipt under the profits interest safe harbor.
C. It is taxed as ordinary wage income subject to withholding by the partnership.
D. It is treated as a taxable capital gain measured against the partner's zero basis.

4. A partner contributes appreciated land with a fair market value of $150,000 and an adjusted basis of $60,000 to a partnership in exchange for a partnership interest. No debt is involved. What is the general tax consequence of this contribution?

A. No gain or loss is recognized, and the partnership takes a carryover basis of $60,000.
B. The partner recognizes $90,000 of taxable gain immediately upon the contribution to the partnership.
C. The partnership must recognize $90,000 of ordinary income upon receiving the contributed property.
D. The partner's basis in the partnership interest is immediately stepped up to $150,000.

5. When a partnership incurs additional recourse debt during the year, what is the general effect on a general partner's outside basis in the partnership?

A. The partner's outside basis increases by their allocable share of the partnership's liabilities.
B. The partner's outside basis is unaffected because liabilities are not a basis item.
C. The partner's outside basis decreases by their allocable share of the partnership's liabilities.
D. The partner's outside basis is capped at the original capital contribution regardless of debt.

6. A partnership has a valid Section 754 election in effect for the tax year. A new partner purchases an existing partner's interest in the partnership for a price exceeding the selling partner's share of the partnership's inside basis in its assets. What is the effect of the Section 754 election on the incoming partner?

A. It reduces the incoming partner's outside basis to match the departing partner's original basis

B. It allows the partnership to step up the incoming partner's share of inside basis in partnership assets
C. It requires the partnership to recognize ordinary income equal to the purchase price difference
D. It eliminates the need for the incoming partner to track any basis in the partnership interest

7. A partnership agreement allocates 90% of depreciation deductions to one partner while allocating income and loss items generally on a 50/50 basis. For this special allocation to be respected by the IRS, what must generally be true?

A. The allocation must simply be stated clearly and unambiguously in the written partnership agreement.
B. The allocation must be approved in writing by the IRS before the partnership's return is filed.
C. The allocation must match the partners' original capital contribution percentages exactly at all times.
D. The allocation must have substantial economic effect, generally requiring proper capital account maintenance.

8. A partner with an outside basis of $30,000 receives a current (nonliquidating) cash distribution of $45,000 from the partnership. What is the tax consequence to the partner?

A. The partner recognizes an ordinary loss of $15,000 equal to the basis shortfall.
B. The partner recognizes no gain because current distributions are always tax-free events.
C. The partner recognizes a capital gain of $15,000, the excess of cash over basis.
D. The partner recognizes $45,000 of ordinary income equal to the full cash received.

9. In a liquidating distribution that terminates a partner's entire interest, the partner receives only cash and no other property. Under what condition may the partner recognize a loss?

A. Loss is recognized only if the cash received is less than the partner's outside basis.
B. Loss is never recognized on any liquidating distribution regardless of the amounts involved.
C. Loss is recognized automatically equal to the partner's original capital contribution amount.
D. Loss is recognized only if the partnership itself reports a net loss for the year.

10. A partner contributes real property with a $200,000 mortgage to the partnership, and the other partners assume a share of that liability. What is the effect of the liability relief on the contributing partner's outside basis?

A. The relief of liability increases the contributing partner's outside basis with no other effect.
B. The relief of liability has no effect on basis because mortgages are ignored in partnerships.
C. The relief of liability is treated as additional taxable ordinary income to the partner.
D. The relief of liability is treated as a deemed cash distribution, reducing the partner's basis.

11. A partner contributes property to a partnership and, thirteen months later, receives a cash distribution that was pre-arranged at the time of contribution. How are these transactions generally treated under the disguised sale rules?

A. The transactions are always disregarded because more than twelve months separated them.
B. The transactions are treated as a tax-free contribution followed by a tax-free distribution.
C. The transactions are treated as a taxable sale of property to the partnership.
D. The transactions are treated as a taxable gift from the partner to the partnership.

12. In a limited partnership with both general and limited partners, how do the liability exposures of the two partner types generally differ for partnership debts?

A. Both general and limited partners have unlimited personal liability for all partnership debts.
B. General partners have unlimited liability, while limited partners' liability is capped at their investment.
C. Limited partners have unlimited liability, while general partners' liability is capped at their investment.
D. Neither general nor limited partners bear any personal liability for partnership obligations at all.

13. A general partner's distributive share of a partnership's ordinary trade or business income is generally treated for self-employment tax purposes in what manner?

A. It is generally subject to self-employment tax as earnings from a trade or business.

B. It is generally exempt from self-employment tax as passive investment income.
C. It is subject to self-employment tax only if separately elected on Form 1065.
D. It is subject to self-employment tax only up to the partner's original capital contribution.

14. A limited partner who does not participate in management receives a distributive share of ordinary income plus a guaranteed payment for services actually rendered to the partnership. Which portion is subject to self-employment tax?

A. Neither the distributive share nor the guaranteed payment is subject to self-employment tax.
B. The distributive share is subject to self-employment tax, but the guaranteed payment is not.
C. The guaranteed payment for services is subject to self-employment tax, but the share generally is not.
D. Both the distributive share and the guaranteed payment are fully subject to self-employment tax.

15. Which of the following best describes a key characteristic of a limited liability partnership (LLP) as compared to a general partnership?

A. Every partner in an LLP has unlimited personal liability for the acts of other partners.
B. Partners in an LLP are generally shielded from personal liability for other partners' malpractice or negligence.
C. An LLP cannot be used by licensed professionals such as accountants or attorneys.
D. An LLP automatically converts to a corporation once it registers with the state.

16. A partnership pays a partner a fixed $60,000 guaranteed payment for services rendered, determined without regard to partnership income. How is this payment generally treated for tax purposes?

A. It is treated as a tax-free return of the partner's capital contribution.
B. It is treated as a nondeductible distribution with no tax effect to either party.
C. It is treated as a dividend, taxed at preferential capital gains rates to the partner.
D. It is generally deductible by the partnership and ordinary income to the receiving partner.

17. Under current federal tax law, a partnership is treated as terminated for tax purposes under IRC Section 708(b)(1) in which of the following circumstances?

A. Whenever more than 50% of partnership interests are sold within a twelve-month period.
B. Whenever a single partner sells their entire interest to an unrelated third party.
C. Whenever the partnership changes its principal place of business during the tax year.
D. When no part of any business continues to be carried on by any partners.

18. A parent gifts a capital interest in a family partnership to an adult child who performs no services for the business. For the child to be recognized as a real partner for tax purposes with respect to that capital interest, what must generally be true?

A. The child must be employed full-time by the partnership performing substantial management duties.
B. Capital must be a material income-producing factor in the partnership's business operations.
C. The parent must retain no ownership interest whatsoever in the partnership after the gift.
D. The partnership must be organized exclusively for the purpose of tax minimization strategies.

19. Four individuals transfer property to a newly formed corporation solely in exchange for stock. For the exchange to qualify for nonrecognition treatment under IRC Section 351, the transferors as a group must own what percentage of the corporation's stock immediately after the exchange?

A. At least 50% of total combined voting power
B. At least 51% of each outstanding class of stock
C. At least 80% of voting stock and each other class
D. At least 100% of every class of stock issued

20. An individual contributes property with a fair market value of $200,000 and an adjusted basis of $120,000 to a controlled corporation in exchange for stock worth $170,000 and $30,000 cash. How much gain must the shareholder recognize on this exchange?

A. $30,000, the amount of boot received
B. $80,000, the entire realized gain
C. $50,000, the excess of stock value over basis
D. $0, because the exchange otherwise qualifies under Section 351

21. Which statement best describes the 'double taxation' concept associated with the C corporation form of business?

A. Shareholders pay tax on corporate income even if no distribution is made during the year
B. Corporate income is taxed at the entity level and again to shareholders when distributed as dividends
C. Both the corporation and its officers must file separate returns reporting the identical income
D. The corporation pays tax twice on the same income if it operates in more than one state

22. Which of the following would disqualify a corporation from making a valid S election?

A. One of the shareholders is a nonresident alien individual
B. The corporation has 90 shareholders, all U.S. citizens
C. A qualified subchapter S trust holds shares as a shareholder
D. An estate of a deceased shareholder holds stock temporarily

23. A calendar-year corporation wants its S election to be effective for the current tax year. By what date must Form 2553 generally be filed?

A. December 31 of the current tax year
B. Anytime during the preceding tax year only
C. The 15th day of the third month of the current tax year
D. April 15 following the close of the current tax year

24. An S corporation's shareholders want to voluntarily revoke the S election effective for the current year. What level of shareholder consent is required?

A. Unanimous written consent of every shareholder of record
B. Consent of shareholders holding at least two-thirds of shares
C. Approval by the board of directors alone, no shareholder vote needed
D. Consent of shareholders holding more than 50% of the outstanding shares

25. An S corporation's election terminated on March 1, Year 1, due to a violation of the passive income limitation. Absent IRS consent, when is the earliest tax year the corporation may generally re-elect S status?

A. Year 6
B. Year 2
C. Year 3
D. Year 4

26. An S corporation shareholder has stock basis of $8,000 and no debt basis. The shareholder's pro rata share of the corporation's ordinary loss for the year is $15,000. How much of the loss may the shareholder currently deduct?

A. $15,000, the full allocated loss
B. $0, because losses require debt basis first
C. $8,000, limited to available stock basis
D. $7,000, the amount exceeding stock basis

27. A C corporation with substantial appreciated assets converts to S corporation status. If those assets are sold within the recognition period following conversion, what tax may apply at the corporate level?

A. Accumulated earnings tax on the gain from the sale
B. Built-in gains tax on the recognized gain from the sale
C. Personal holding company tax on the appreciated asset gain
D. Alternative minimum tax assessed directly against the corporation

28. Under the check-the-box regulations, absent an affirmative election, how is a domestic LLC with three members automatically classified for federal income tax purposes?

A. As a disregarded entity reporting on the owner's return

B. As a C corporation subject to entity-level tax
C. As a sole proprietorship reporting on Schedule C
D. As a partnership filing Form 1065 annually

29. A single individual owns 100% of a domestic LLC and has made no entity classification election. How is the LLC treated for federal income tax reporting purposes?

A. As a C corporation required to file Form 1120
B. As a partnership required to file Form 1065
C. As a disregarded entity reported on the owner's Form 1040
D. As an S corporation required to file Form 1120-S

30. A tax practitioner is comparing an LLC taxed as a partnership against an S corporation for a profitable service business. Which factor commonly favors the S corporation structure?

A. Greater flexibility in special allocations of income and loss
B. Potential to reduce self-employment tax on reasonable-salary structuring
C. Ability to have an unlimited number of eligible shareholders
D. Automatic exemption from state-level franchise or entity taxes

31. In a complete liquidation of a C corporation, how does the corporation generally treat the distribution of appreciated property to its shareholders?

A. The corporation recognizes gain as if the property were sold at fair market value
B. No gain is recognized because liquidating distributions are always tax-free events
C. Gain recognition is deferred until the shareholder later disposes of the property
D. Only the shareholder recognizes gain; the corporation reports no taxable event

32. A qualified personal service corporation, such as one owned entirely by licensed accountants performing accounting services, is taxed under current law at what corporate income tax rate?

A. A special reduced rate of 15% on all taxable income
B. A graduated rate structure identical to individual taxpayers
C. A surtax rate of 35% applied above regular corporate rates
D. The same flat 21% rate that applies to other C corporations

33. The IRS may impose the accumulated earnings tax on a C corporation under which circumstance?

A. The corporation distributes all current earnings as dividends each year
B. Earnings are accumulated beyond reasonable business needs to avoid shareholder tax
C. The corporation elects S status after previously operating as a C corporation
D. Shareholders sell their stock at a substantial gain during the year

34. A former C corporation that elected S status has accumulated earnings and profits from its C corporation years. If passive investment income exceeds what percentage of gross receipts for three consecutive years, the S election is terminated?

A. 15%
B. 20%
C. 25%
D. 50%

35. An S corporation wants its wholly owned corporate subsidiary to be treated as a Qualified Subchapter S Subsidiary (QSub). What ownership requirement must be met for the election to be valid?

A. The parent S corporation must own 100% of the subsidiary's stock
B. The parent must own at least 80% of the subsidiary's voting stock
C. At least two shareholders must jointly own the subsidiary corporation
D. The subsidiary must itself independently qualify to elect S status

36. A retail business using the accrual method received a $12,000 advance payment in December 2025 for merchandise to be delivered to the customer in January 2026. The business also defers the corresponding amount of income for financial statement purposes. Under the general rule for advance payments for goods, when must the business include the $12,000 in gross income?

A. In 2026, when the merchandise is actually delivered to the customer
B. Ratably over 2025 and 2026 based on the delivery schedule used
C. Only when the merchandise is delivered or the return period expires
D. In 2025, the year of receipt, unless the one-year deferral method under Section 451(c) applies

37. A sole proprietor wants to deduct several expenses paid during the year and is applying the ordinary and necessary standard of IRC Section 162. Which of the following best describes the 'ordinary' component of this two-part test?

A. The expense must be indispensable to operating the business
B. The expense must be capitalized rather than currently expensed
C. The expense must be common and accepted in the trade or business
D. The expense must be reasonable in amount compared to industry norms

38. A tax practitioner is advising several business clients on eligibility for the cash method of accounting. Which of the following entities may generally use the cash method for tax purposes without regard to the average annual gross receipts test?

A. A qualified personal service corporation, regardless of gross receipts
B. A C corporation with $30 million in average annual gross receipts
C. A business required to account for inventories under Section 471
D. A tax shelter as defined under Section 448 of the Code

39. A business files Form 3115 to voluntarily change its method of accounting for tax purposes, and the change produces a positive Section 481(a) adjustment of $40,000. Absent a de minimis exception, how is this adjustment generally reported?

A. Entirely in the year of change
B. Over the two years following the year of change

C. Entirely in the year preceding the change
D. Ratably over four years beginning with the year of change

40. A wholesale business is considering switching its inventory valuation method from FIFO to LIFO during a sustained period of rising prices. Compared to FIFO, what effect would this switch generally have?

A. Higher ending inventory value and higher taxable income
B. Lower ending inventory value and lower taxable income
C. No change in taxable income, only a change in reporting format
D. Higher cost of goods sold under FIFO than under LIFO

41. A merchandising business reports beginning inventory of $50,000, purchases of $200,000, and ending inventory of $60,000 for the tax year. What is the business's cost of goods sold for the year?

A. $210,000
B. $250,000
C. $190,000
D. $110,000

42. A cash-method consulting business performed services for a client but was never paid the $4,000 fee. The client's obligation became wholly worthless during the year. Which statement correctly describes the business's ability to claim a bad debt deduction?

A. No deduction is allowed since the income was never reported as gross income
B. The debt is deductible in full using the specific charge-off method
C. The debt is deductible as a short-term capital loss
D. The debt is deductible only using the reserve method

43. An individual who is not in the business of lending money personally loans money to a friend, and the loan becomes wholly worthless during the year. How must this loss be treated on the individual's tax return?

A. Ordinary loss deductible in full against business income
B. Short-term capital loss regardless of how long the loan was outstanding
C. Deductible only if the loan was made in the course of business
D. Partially deductible using the specific charge-off method

44. A new business incurs $53,000 of start-up expenditures before beginning active operations. Under IRC Section 195, what is the correct tax treatment of these costs?

A. The full $53,000 is deductible immediately as an ordinary and necessary expense
B. All $53,000 must be capitalized and amortized ratably over 15 years, with no immediate deduction
C. $5,000 is immediately deductible, and the remaining $48,000 is amortized ratably over 180 months
D. The $5,000 deduction is reduced to $2,000 since costs exceed $50,000, and the balance is amortized over 180 months

45. A newly formed corporation incurs $8,000 of organizational expenditures, consisting of legal and accounting fees to create the corporate charter, in its first year of existence. Under IRC Section 248, how are these costs treated?

A. The full $8,000 is deductible immediately as an ordinary business expense
B. All $8,000 must be capitalized indefinitely with no amortization permitted
C. $8,000 must be amortized ratably over exactly 60 months with no immediate deduction
D. Up to $5,000 is immediately deductible, and the remaining $3,000 is amortized ratably over 180 months

46. A self-employed consultant takes a prospective client to dinner to discuss a potential engagement. The meal costs $200 and is not lavish or extravagant under the circumstances. Assuming no special exception applies, what amount may the consultant deduct?

A. $100, since business meals are generally limited to 50% of the cost
B. $200, the full cost, since it was ordinary and necessary
C. $0, because business meals are no longer deductible at all

D. $150, based on a 75% limitation for client meals

47. To substantiate a business travel expense deduction under the adequate records rule, a taxpayer must generally document each element of the expense. Which of the following is NOT one of the required elements?

A. The amount of the expense
B. The taxpayer's marginal tax rate for the year
C. The time and place of the travel
D. The business purpose of the trip

48. A manufacturing business is applying the uniform capitalization rules of IRC Section 263A to determine which costs must be included in inventory. Which of the following costs must generally be capitalized rather than currently deducted?

A. Selling and marketing expenses incurred by the business
B. Research and experimental expenditures under Section 174
C. Indirect production costs such as factory storage and handling
D. Distribution costs incurred after the goods are sold

49. A cash-method business pays $2,400 in December 2025 for a business insurance policy providing coverage from January 1, 2026 through December 31, 2026. Under the 12-month rule for prepaid expenses, how is this payment treated?

A. Must be capitalized and amortized over the life of the related asset
B. Deducted 50% in 2025 and 50% in 2026 based on proration
C. Deferred entirely until the policy period begins in 2026
D. Deductible in full in 2025 under the 12-month rule for prepaid expenses

50. A business owner gives each of five clients a holiday gift basket costing $40 per basket. Applying the business gift deduction limitation, what is the maximum amount deductible per client?

A. $40, the full cost of each gift basket is deductible
B. $20, half the cost is deductible per client per year
C. $25, the maximum allowed per recipient under the gift limitation
D. $0, business gifts are never deductible under any circumstances

51. A calendar-year business placed $200,000 of 5-year MACRS property in service during the year, with $130,000 of that total placed in service during the fourth quarter. Which depreciation convention must the business use for all of its 2025 personal property additions?

A. Half-year convention, because it is the default method for all personal property
B. Mid-quarter convention, because more than 40% of the year's basis was placed in service in the fourth quarter
C. Mid-month convention, because the property is real property
D. Full-year convention, because the property was in service more than half the year

52. For tax year 2025, a sole proprietor's business generated $95,000 of taxable income before any Section 179 deduction, and the owner purchased $40,000 of qualifying equipment. The Section 179 deduction is limited to which amount?

A. $40,000, because the business-income limitation is not exceeded
B. $28,900, because Section 179 is capped at 30% of taxable income
C. $0, because equipment does not qualify for Section 179
D. $95,000, because Section 179 always equals total taxable income

53. A business purchased new qualified machinery and placed it in service in 2025. Compared to Section 179 expensing, which statement best describes bonus depreciation under Section 168(k) for this property?

A. It is limited to the taxpayer's business taxable income for the year
B. It may only be claimed on used property acquired from a related party
C. It can create or increase a net operating loss because there is no taxable-income limitation
D. It requires the taxpayer to elect out annually, or it is automatically disallowed

54. A taxpayer uses a passenger automobile 60% for business and 40% for personal purposes. How does this business-use percentage affect the vehicle's depreciation under the listed property rules?

A. It has no effect because vehicles are exempt from listed property rules
B. Depreciation must be computed only on the business-use portion, and luxury auto dollar limits still apply
C. The vehicle no longer qualifies for any depreciation deduction at all
D. The taxpayer may depreciate 100% of the cost since business use exceeds 50%

55. Following the Tax Cuts and Jobs Act, a business exchanges an office building for another office building of like kind, deferring gain under Section 1031. Which of the following is true of this exchange today?

A. Like-kind exchange treatment now applies broadly to both real and personal business property
B. The exchange no longer qualifies because Section 1031 was fully repealed
C. Gain deferral is available only if both properties are located outside the United States
D. Like-kind exchange treatment is limited exclusively to exchanges of real property held for business or investment

56. A business sold two pieces of Section 1231 property during the year: one generated a $30,000 gain and the other generated a $12,000 loss. After netting, how is the net result treated?

A. As an $18,000 long-term capital gain
B. As an $18,000 ordinary loss
C. As a $30,000 ordinary gain and a separate $12,000 capital loss
D. As fully ordinary income because losses always convert gains to ordinary

57. A business sells equipment for $50,000 that originally cost $60,000 and had accumulated depreciation of $45,000, giving it an adjusted basis of $15,000. How is the $35,000 gain characterized under Section 1245?

A. Entirely as Section 1231 long-term capital gain

B. Entirely as a capital loss

C. As $15,000 ordinary income and $20,000 capital gain

D. Entirely as ordinary income up to the amount of depreciation claimed

58. A business sells nonresidential real property that was depreciated using the straight-line MACRS method, producing a gain attributable entirely to depreciation taken. Under Section 1250, how is this gain generally treated for a taxpayer who used straight-line depreciation throughout?

A. Fully recaptured as ordinary income because all real property depreciation is recaptured

B. Treated as unrecaptured Section 1250 gain, taxed at capital gain rates with a special maximum rate

C. Entirely exempt from tax because straight-line depreciation avoids all recapture

D. Recaptured as ordinary income only for the first year of ownership

59. A business computes a general business credit for the year that exceeds its net income tax liability after certain adjustments. What generally happens to the excess credit amount?

A. It may generally be carried back one year and then carried forward up to twenty years

B. It is permanently forfeited in the year it cannot be used

C. It must be refunded immediately regardless of tax liability

D. It converts automatically into a Section 179 deduction for the following year

60. An employer hires an individual who has been receiving Supplemental Nutrition Assistance Program benefits for at least the preceding six months. To claim the Work Opportunity Tax Credit for this hire, what must the employer first do?

A. Wait until the employee has worked a full calendar year before filing anything

B. Automatically receive the credit with no certification process required

C. Obtain certification that the individual is a member of a targeted group, generally using Form 8850

D. File the credit claim only after the employee's second year of employment

61. A business incurs qualified research expenses while developing a new manufacturing process, including wages for researchers and supplies consumed in the research. Which credit is designed to reward this type of qualified research activity?

A. The research and development credit under Section 41
B. The Work Opportunity Tax Credit
C. The low-income housing credit
D. The disabled access credit

62. A sole proprietor has $80,000 of qualified business income and $90,000 of taxable income before the QBI deduction, with no net capital gain. What is the QBI deduction, assuming no wage or income limitations apply?

A. $90,000, because the deduction equals taxable income
B. $32,000, because 40% of QBI is always deductible
C. $16,000, the lesser of 20% of QBI or 20% of taxable income
D. $18,000, based solely on 20% of taxable income

63. A taxpayer's taxable income exceeds the applicable QBI threshold for high-income taxpayers, and the business is not an SSTB. For a non-SSTB business above the threshold, the QBI deduction becomes limited to the greater of which two amounts?

A. 20% of gross receipts or 10% of net income
B. Total wages paid or total depreciation claimed for the year
C. Net capital gain or ordinary business income
D. 50% of W-2 wages, or 25% of W-2 wages plus 2.5% of UBIA of qualified property

64. A taxpayer operates a solo law practice and reports taxable income well above the upper threshold for specified service trades or businesses. How is the taxpayer's QBI deduction treated for this legal practice?

A. Fully allowed at 20% of QBI with no restrictions

B. Completely disallowed because law is a specified service trade or business above the upper threshold
C. Allowed only for wages paid to paralegal staff
D. Automatically doubled because legal services are favored under QBI rules

65. A business installs qualifying solar energy property at its commercial facility. Which credit is specifically designed to encourage this type of business investment in renewable energy equipment?

A. The Work Opportunity Tax Credit
B. The business energy investment credit
C. The earned income tax credit
D. The child and dependent care credit

66. For 2025, a business must withhold Social Security tax from each employee's wages and match that amount with an equal employer contribution. At what rate is the Social Security portion of FICA tax computed?

A. 1.45 percent, matched by the employer with no annual wage limit
B. 2.9 percent combined, withheld only from self-employed individuals
C. 7.65 percent, representing the full Medicare tax rate alone
D. 6.2 percent, matched by the employer up to the annual wage base

67. The standard FUTA tax rate is 6.0 percent on the first $7,000 of each employee's annual wages, but employers typically receive a credit reducing the effective rate to 0.6 percent. If an employer operates in a credit-reduction state with a reduction of 0.3 percent, what is the employer's effective FUTA rate for that state?

A. 0.9 percent, reflecting the standard effective rate plus the reduction
B. 0.6 percent, the normal effective rate after the full credit
C. 1.2 percent, doubling the standard effective FUTA rate amount
D. 6.0 percent, the full rate applied before any credit

68. A company hires a worker and directs precisely how, when, and where the work must be performed, provides all training, and supervises each step of the process. Under the IRS common-law control test, which factor here MOST strongly indicates an employer-employee relationship rather than independent contractor status?

A. The worker sets their own hours across several different clients
B. The worker submits invoices only after each project is completed
C. The business controls the methods, timing, and location of the work
D. The worker supplies their own tools and equipment for each job

69. A small business is unsure whether a long-term worker should be treated as an employee or an independent contractor and wants a formal IRS ruling on the matter before filing its next employment tax return. Which form should the business file to request this determination?

A. Form 8919, Uncollected Social Security and Medicare Tax on Wages
B. Form SS-8, Determination of Worker Status for Employment Taxes
C. Form W-9, Request for Taxpayer Identification Number and Certification
D. Form 2553, Election by a Small Business Corporation

70. A self-employed consultant who qualifies for the home office deduction wants to avoid tracking actual utility bills, depreciation, and repair costs. Under the simplified method, how is the deduction computed?

A. A flat $5 per square foot of office space, capped at 300 square feet
B. Actual expenses prorated by the business-use percentage, with no cap
C. A flat $10 per square foot, up to 500 square feet total
D. A flat $1,500 deduction regardless of the office's actual size

71. A taxpayer uses a spare bedroom as their home office for a consulting business on weekdays, but the same room doubles as a playroom for their children every weekend. Can the taxpayer claim the home office deduction for this room?

A. Yes, because business use predominates during the workweek
B. Yes, as long as personal usage is documented in a log
C. No, because the space is not used exclusively for business
D. No, unless the taxpayer works exclusively from home full time

72. An employer provides each employee with $75,000 of group-term life insurance coverage at no cost to the employees. How is the cost of coverage in excess of $50,000 treated for tax purposes?

A. Fully deductible by the employer and fully excludable by employees
B. Nondeductible to the employer and fully excludable by employees
C. Deductible by the employer only if the premium is paid in cash
D. Deductible by the employer but includible in each employee's taxable wages

73. Absent indications of fraud or a substantial understatement of income, how long should a business generally retain the records that support the income and deductions reported on a filed tax return?

A. 2 years from the date the return was filed
B. 4 years from the original due date of the return
C. 3 years from the date the return was filed
D. 7 years from the close of the tax year involved

74. A tax practitioner is explaining estimated tax obligations to a client who owns a C corporation and also holds an interest in a partnership. Which statement correctly describes how these businesses generally handle estimated tax payments?

A. Corporations never make estimated payments; only their owners are required to
B. Partners pay estimated tax collectively through the partnership's own EIN
C. S corporation shareholders always have tax withheld directly by the corporation
D. The C corporation itself pays estimated tax, while the partner pays individually

75. A calendar-year partnership needs to know its original filing deadline for Form 1065 and the length of the automatic extension available if it cannot file on time. Which combination is correct?

A. April 15, original due date, with a five-month automatic extension
B. March 15, original due date, with a six-month automatic extension
C. March 15, original due date, with a five-month automatic extension
D. April 15, original due date, with a six-month automatic extension

76. A business incurs a net operating loss in the current tax year. Under current law, with no carryback generally allowed, how is the NOL deduction limited when it is carried forward to offset income in a future profitable year?

A. Limited to 80 percent of taxable income in the carryforward year
B. Fully deductible against 100 percent of future taxable income
C. Limited to 50 percent of taxable income for five years only
D. Carried back two years automatically before any carryforward is permitted

77. A single, noncorporate taxpayer's sole proprietorship generates aggregate business deductions that exceed aggregate business gross income by an amount well above the annual excess business loss threshold for the year. Under Section 461(l), what happens to the disallowed portion of that loss?

A. It is permanently disallowed and can never be used again
B. It is treated as a net operating loss and carried forward
C. It automatically offsets only the taxpayer's investment portfolio income
D. It directly reduces the taxpayer's self-employment tax liability instead

78. A corporation with significant business debt is calculating its allowable interest expense deduction. Under Section 163(j), the deduction for net business interest expense is generally limited to business interest income plus what percentage of the business's adjusted taxable income?

A. 20 percent of adjusted taxable income for the tax year
B. 50 percent of adjusted taxable income for the tax year
C. 30 percent of adjusted taxable income for the tax year
D. 40 percent of adjusted taxable income for the tax year

79. A small business consistently has average annual gross receipts well below the inflation-adjusted small business threshold for the prior three tax years. How does this affect the business's exposure to the Section 163(j) business interest expense limitation?

A. The business qualifies for the small business exception to the limitation
B. Only C corporations may ever qualify for this small business exception
C. The exception applies solely to businesses that carry no debt at all
D. All service-based businesses are exempt from the limitation regardless of size

80. An estate's fiduciary must file Form 1041, U.S. Income Tax Return for Estates and Trusts, for the tax year if the estate has gross income of at least what amount, or a beneficiary who is a nonresident alien?

A. $400
B. $500
C. $1,000
D. $600

81. Distributable net income (DNI) serves what primary function on a fiduciary income tax return?

A. It sets the maximum charitable deduction the trust may claim for the year
B. It determines the trustee's annual fee deductible on Form 1041
C. It caps trust income taxable to beneficiaries and the trust's distribution deduction
D. It fixes the trust's exemption amount used in computing taxable income

82. Which characteristic distinguishes a simple trust from a complex trust for federal income tax purposes?

A. It must distribute all income currently and cannot distribute corpus or make charitable gifts
B. It may accumulate income, distribute principal, and claim a charitable contribution deduction
C. It is exempt from filing Form 1041 regardless of the amount of income earned

D. It is automatically classified as a grantor trust for the life of the grantor

83. A business owner creates an irrevocable trust but retains the power to substitute trust assets with property of equivalent value. Under the grantor trust rules, how is the trust's income generally treated?

A. It is taxed entirely to the trust at compressed trust tax rates
B. It is taxed to the grantor on the grantor's individual income tax return
C. It is split equally between the grantor and the named beneficiaries
D. It is taxed to the beneficiaries regardless of whether any distributions were made

84. A tax-exempt organization has gross receipts of $45,000 for the year and total assets under $500,000. Which annual information return may it file with the IRS?

A. Form 990 only, since gross receipts exceed the small-organization threshold
B. Form 990-PF, since all organizations with under $50,000 in receipts file as private foundations
C. No return is required for any organization under $50,000 in gross receipts
D. Form 990-N, the electronic notice, since gross receipts are normally $50,000 or less

85. A tax-exempt charitable organization operates a printing business unrelated to its exempt purpose, regularly carried on with volunteer labor making up less than half the workforce. How is the net income from this activity generally treated?

A. It is fully exempt because the organization itself holds 501(c)(3) status
B. It is exempt as long as the profits are used for the exempt purpose
C. It is taxed only if gross receipts from the activity exceed $1 million
D. It is subject to unrelated business income tax, reported on Form 990-T

86. Under current law, what excise tax rate applies to a private foundation's net investment income?

A. A flat 1.39 percent excise tax on net investment income
B. A graduated rate ranging from 15 to 37 percent

C. A flat 21 percent corporate excise tax rate

D. No excise tax applies as long as minimum distributions are met

87. A small business owner wants a qualified retirement plan that promises employees a specified monthly benefit at retirement based on salary and years of service, with the employer bearing the investment risk. Which plan type fits this description?

A. A defined contribution plan, since benefits are based on individual account balances

B. A defined benefit plan, since the benefit formula is fixed and the employer funds it

C. A SIMPLE IRA plan, since it always guarantees a fixed monthly payout

D. A profit-sharing plan, since contributions vary annually with company profits

88. For 2024, an employer's contribution to an employee's SEP IRA is generally limited to the lesser of $69,000 or what percentage of the employee's compensation?

A. 10 percent of compensation

B. 15 percent of compensation

C. 25 percent of compensation

D. 50 percent of compensation

89. A farmer sells raised dairy cattle held for draft, breeding, or dairy purposes. Where does the farmer report the gain from this sale?

A. On Schedule F as ordinary farm income from the sale of livestock

B. On Schedule C as income from a separate farming trade or business

C. On Schedule D only, with no distinction for the type of livestock sold

D. On Form 4797, since the cattle were depreciable business property, not inventory

90. A farmer had an unusually high-income year from crop sales. Farm income averaging on Schedule J allows the farmer to do what with the elected farm income?

A. Defer the elected income into the following tax year entirely
B. Exclude the elected income from tax permanently up to a set dollar cap
C. Spread the elected income back over the prior three base years to compute tax
D. Convert the elected income into long-term capital gain automatically

91. A taxpayer wants rental real estate losses to be treated as nonpassive under the real estate professional exception. Which requirement must also be met, in addition to material participation in the rental activity?

A. Performing more than half of all personal services, and over 750 hours, in real property trades or businesses
B. Holding a real estate broker or sales agent license issued by the applicable state
C. Owning at least five separate rental properties at some point during the tax year
D. Generating gross rental income exceeding $150,000 for the activity during the tax year

92. A farmer trades an old tractor for a newer tractor of like kind, plus cash boot. Under current federal tax law following the Tax Cuts and Jobs Act, how is this exchange treated?

A. The exchange qualifies for full like-kind exchange nonrecognition, as it always has for farm equipment
B. The exchange is fully taxable, since Section 1031 now applies only to real property, not equipment
C. The exchange is nontaxable only if both tractors are used exclusively for dairy farming
D. The exchange qualifies for partial deferral limited strictly to the cash boot received

93. For Form 706 purposes, how is a decedent's interest in a closely held business generally valued?

A. At the original cost basis the decedent paid to acquire the business interest
B. At fair market value, factoring in relevant discounts such as lack of marketability or minority ownership
C. At the book value shown on the business's most recent balance sheet
D. At the replacement cost of the business's tangible assets alone

94. A business owner funds a charitable remainder trust with appreciated stock from a business sale, retaining an annuity or unitrust interest for life with the remainder passing to charity. What is a key tax benefit of this arrangement?

A. The owner recognizes the full capital gain immediately but avoids all future income tax
B. The trust is automatically classified as a grantor trust taxed entirely to the owner
C. The charity pays income tax on the trust's investment earnings each year
D. The trust sells the appreciated stock without immediate recognition of capital gain

95. A complex trust makes distributions to three beneficiaries during the year, and total distributions exceed distributable net income. How is DNI generally allocated among the beneficiaries for tax reporting purposes?

A. Entirely to the beneficiary with the largest total distribution for the year
B. Equally among the beneficiaries regardless of how much each actually received
C. Proportionately, based on each beneficiary's share of the total amount distributed
D. According to the trust document's stated priority of distributions, if any exists

96. A trustee wants a distribution made in February, within the first 65 days of the new tax year, to be treated as if made on the last day of the trust's preceding tax year. What allows this treatment?

A. The Section 663(b) election, commonly called the 65-day rule
B. An automatic extension granted whenever Form 1041 is filed late
C. The grantor trust rules, which disregard the trust's own tax year
D. The alternate valuation date election under Section 2032

97. A private foundation must distribute a minimum amount for charitable purposes each year to avoid an excise tax on undistributed income. This minimum distribution requirement is generally calculated as approximately what percentage of the foundation's net investment assets?

A. 5 percent of the average fair market value of net investment assets
B. 10 percent of gross investment income for the year

C. 1.39 percent of net investment income, matching the excise tax rate
D. 25 percent of total assets held at the close of the tax year

98. An employer establishes a SIMPLE IRA plan for its small business employees. Under the standard matching formula, what is the employer generally required to contribute?

A. A fixed 3 percent of compensation for every employee, whether or not they defer
B. A dollar-for-dollar match up to 3 percent of compensation for employees who defer
C. A flat $5,000 contribution per eligible employee regardless of deferrals made
D. No employer contribution is required if the business has fewer than ten employees

99. A newly formed 501(c)(3) organization does not affirmatively establish that it qualifies as a public charity. How is it classified by default?

A. As a public charity automatically, since 501(c)(3) status implies public charity treatment
B. As a governmental unit exempt from all excise tax provisions
C. As a private foundation, subject to the stricter private foundation excise tax rules
D. As a social welfare organization under Section 501(c)(4) instead

100. A taxpayer actively participates in a rental real estate activity but does not qualify as a real estate professional. Assuming modified adjusted gross income is within the applicable phase-out range, what is the maximum special allowance for rental real estate losses against nonpassive income?

A. $10,000
B. $15,000
C. $20,000
D. $25,000

Answer Key and Explanations — Practice Exam 15, Part 2: Businesses

1. D — A sole proprietorship is not a separate legal entity from its owner, so business and personal assets are not shielded from creditors. Unlike a corporation or LLC, there is no liability shield, meaning the proprietor's personal assets, including savings and property outside the business, remain fully exposed to judgments arising from business debts and obligations.

2. C — Sole proprietors report business income and expenses on Schedule C, which flows through to Form 1040. Net profit is subject to ordinary income tax and, because the owner is not a W-2 employee, is also subject to self-employment tax covering Social Security and Medicare, computed separately on Schedule SE using net earnings from self-employment.

3. B — Under Revenue Procedure 93-27, the receipt of a pure profits interest in exchange for services is generally not a taxable event, provided the partner does not dispose of the interest within two years and certain other safe-harbor conditions are satisfied. This differs from receiving a capital interest, which is taxable as compensation at grant.

4. A — Under IRC Section 721, no gain or loss is recognized when property is contributed to a partnership solely in exchange for a partnership interest. The partnership takes a carryover, or transferred, basis in the contributed property equal to the contributing partner's adjusted basis, preserving the built-in gain for later recognition by the partnership.

5. A — A partner's outside basis includes their share of partnership liabilities under Section 752, because the partner is treated as if they contributed cash equal to that share. An increase in partnership recourse or nonrecourse debt allocated to a partner therefore increases that partner's outside basis, while a decrease in debt reduces it.

6. B — A Section 754 election allows a partnership to adjust the basis of partnership property under Section 743(b) when an interest is transferred, stepping up or down the transferee partner's share of inside basis to reflect the price actually paid for the interest. This prevents the incoming partner from being taxed again on appreciation that occurred before the purchase.

7. D — Special allocations that differ from a partner's overall interest in the partnership are respected only if they have substantial economic effect under Section 704(b). This generally requires capital accounts to be maintained under the regulations, liquidating distributions to follow those capital account balances, and any partner with a deficit balance to be obligated to restore it.

8. C — A partner generally recognizes gain on a current distribution only to the extent that cash received exceeds the partner's outside basis immediately before the distribution. Here, the $45,000 cash distribution exceeds the $30,000 basis by $15,000, which is treated as gain from the sale or exchange of the partnership interest, typically capital in character.

9. A — A partner may recognize a loss on a liquidating distribution only when the distribution consists solely of cash, unrealized receivables, and inventory, with no other property received, and the total of those amounts is less than the partner's outside basis. The loss recognized equals that basis shortfall and is generally treated as capital loss.

10. D — When a partner contributes encumbered property, the assumption of that liability by the other partners reduces the contributing partner's individual share of the debt. This net relief of liability is treated as a deemed cash distribution under Section 752, which decreases the contributing partner's outside basis and can trigger gain if it exceeds that basis.

11. C — Under Section 707(a)(2)(B), when a contribution of property and a related distribution to the contributing partner are so linked that the distribution would not have occurred but for the contribution, the transaction is recast as a disguised sale. A rebuttable presumption of sale treatment applies to transfers occurring within two years of each other.

12. B — In a limited partnership, general partners manage the business and bear unlimited personal liability for partnership debts and obligations, similar to a sole proprietor. Limited partners, by contrast, typically do not participate in management and their liability exposure is generally limited to the amount of their capital investment in the partnership, protecting personal assets beyond that.

13. A — A general partner is treated much like a sole proprietor with respect to the partnership's trade or business income, because general partners actively participate in management and bear liability for the business. As a result, a general partner's distributive share of ordinary trade or business income is generally subject to self-employment tax, reported on Schedule SE.

14. C — A limited partner's distributive share of partnership income is generally excluded from self-employment tax because limited partners typically do not actively participate in the business. However, a guaranteed payment received for services actually performed for the partnership is treated as compensation for services and remains subject to self-employment tax regardless of the partner's limited status.

15. B — A limited liability partnership modifies the general partnership form by shielding individual partners from personal liability for the malpractice, negligence, or misconduct of other partners, while typically still allowing partners to participate in management. LLPs are commonly used by licensed professional groups, such as law firms and accounting firms, that want liability protection without forming a corporation.

16. D — Guaranteed payments are amounts paid to a partner for services or for the use of capital, determined without regard to partnership income, similar to compensation. The partnership generally deducts the guaranteed payment as a business expense, and the recipient partner reports it as ordinary income, subject to self-employment tax when paid for services rendered.

17. D — The Tax Cuts and Jobs Act repealed the technical termination rule that previously applied when 50% or more of partnership interests were sold within twelve months. Under current law, a partnership terminates for tax purposes under Section 708(b)(1) only when no part of any business, financial operation, or venture continues to be carried on by any partners in partnership form.

18. B — Under the family partnership rules, a donee family member who receives a capital interest by gift, without performing services, is recognized as a real partner only if capital is a material income-producing factor for the business, such as manufacturing. In service-based partnerships where capital is not material, the gifted interest is generally disregarded for tax purposes.

19. C — Section 351 requires the transferors, as a group, to be in 'control' immediately after the exchange — owning at least 80% of total voting power and at least 80% of each nonvoting stock class, per Section 368(c). Falling short of this threshold makes the entire exchange taxable, with transferors recognizing gain or loss on property contributed.

20. A — Under Section 351(b), when a transferor receives boot (cash or other property) in addition to stock, gain is recognized to the lesser of the realized gain or the boot received. Realized gain is $80,000 ($200,000 minus $120,000 basis), but only the $30,000 cash received is boot, so recognized gain is limited to $30,000.

21. B — A C corporation is a separate taxable entity, so its net income is taxed at the corporate level. When after-tax earnings are later distributed to shareholders as dividends, the shareholders report and pay individual income tax on those same dollars again, creating two layers of tax on one economic stream of corporate income.

22. A — S corporations may only have eligible shareholders: individuals who are U.S. citizens or resident aliens, certain trusts, and estates. Nonresident aliens are specifically prohibited from holding S corporation stock. A shareholder count of 90 (under the 100-shareholder limit), a qualified subchapter S trust, and an estate are all permissible, so only the nonresident alien shareholder disqualifies the election.

23. C — To be effective for the current tax year, Form 2553 must be filed by the 15th day of the third month of that tax year (March 15 for calendar-year corporations). An election filed after this deadline generally becomes effective for the following tax year instead, unless the corporation qualifies for late-election relief provisions.

24. D — A voluntary revocation of an S election requires the consent of shareholders owning more than 50% of the corporation's outstanding shares, counting both voting and nonvoting shares, on the day the revocation is made. This is a notably lower threshold than the unanimous shareholder consent required to originally elect S status under Form 2553.

25. A — Once an S election terminates, the corporation is generally barred from re-electing S status for five tax years following the year of termination, absent IRS consent to an earlier election. Since termination occurred in Year 1, the five-year waiting period runs through Year 5, making Year 6 the earliest year a new election can generally be made.

26. C — A shareholder's deductible share of S corporation losses is limited to the sum of stock basis plus debt basis. With $8,000 of stock basis and no debt basis, the shareholder may deduct only $8,000 of the $15,000 loss in the current year. The remaining $7,000 is suspended and carried forward until additional basis becomes available.

27. B — When a C corporation elects S status while holding appreciated assets, gain recognized on disposition of those assets within the five-year recognition period is subject to the built-in gains tax at the corporate level, taxed at the highest corporate rate. This prevents corporations from using an S election to avoid corporate-level tax on pre-conversion appreciation.

28. D — Under the check-the-box regulations, a domestic LLC with two or more members is classified by default as a partnership for federal income tax purposes, filing Form 1065 annually, unless its members affirmatively elect corporate treatment on Form 8832. A single-member LLC instead defaults automatically to disregarded entity status rather than partnership treatment.

29. C — Absent an election, a single-member LLC owned by an individual is a disregarded entity for federal income tax purposes. Its income and expenses are reported directly on the owner's Form 1040, typically on Schedule C, E, or F, rather than on a separate business return, though the LLC is still respected for employment and certain excise taxes.

30. B — S corporation shareholder-employees pay only income tax, not self-employment tax, on corporate profits distributed beyond reasonable W-2 compensation, often meaningfully reducing overall payroll tax exposure compared to partnership self-employment income. Partnerships, by contrast, generally allow much greater flexibility in special income allocations, which S corporations cannot offer due to the one-class-of-stock requirement.

31. A — Under IRC Section 336, a liquidating corporation generally recognizes gain or loss on distributed property as though the property were sold to the shareholder at its fair market value. The shareholder separately recognizes gain or loss on the exchange of stock for the liquidating distribution, resulting in taxation at both the corporate and shareholder levels.

32. D — Since the Tax Cuts and Jobs Act eliminated graduated corporate rates, all C corporations, including qualified personal service corporations, are taxed at a flat 21% rate on taxable income. Personal service corporations no longer face a separately higher flat rate; their distinguishing tax issues now primarily involve reasonable compensation and accounting method restrictions.

33. B — The accumulated earnings tax is a penalty tax imposed on C corporations that accumulate earnings beyond the reasonable needs of the business in order to shield shareholders from individual tax on dividends. It does not apply to corporations that distribute earnings currently or that can demonstrate a legitimate business purpose for retained earnings.

34. C — An S corporation with accumulated earnings and profits carried over from prior C corporation years faces mandatory termination of its S election if passive investment income exceeds 25% of gross receipts for three consecutive tax years. In the years leading up to termination, excess net passive income may also be subject to a separate corporate-level tax.

35. A — A Qualified Subchapter S Subsidiary election requires the parent S corporation to own 100% of the subsidiary's stock. Once the election is made, the subsidiary is treated as disregarded from its parent for federal income tax purposes, with all of its assets, liabilities, and income treated as belonging directly to the parent S corporation.

36. D — Under the accrual method, advance payments for goods or services are generally included in gross income in the year received. However, IRC Section 451(c) permits qualifying taxpayers to defer recognition of the unearned portion to the following tax year if they also defer that amount for financial statement reporting purposes, aligning tax and book treatment somewhat.

37. C — The 'ordinary' requirement under Section 162 means the expense must be common and accepted in the taxpayer's particular trade or business, not necessarily habitual for that specific taxpayer. 'Necessary' means helpful and appropriate for the business, not indispensable. An expense meeting both tests, and not otherwise a personal or capital expenditure, is deductible.

38. A — Qualified personal service corporations may use the cash method of accounting regardless of average annual gross receipts. In contrast, most other C corporations and partnerships with C corporation partners must use the accrual method once gross receipts exceed the applicable threshold, and businesses required to account for inventories generally cannot use the cash method.

39. D — A voluntary accounting method change requires filing Form 3115 with the IRS. A resulting positive Section 481(a) adjustment, which prevents income from being duplicated or omitted, is generally spread ratably over four tax years beginning with the year of change, rather than recognized entirely in a single year, smoothing the impact on taxable income across the adjustment period.

40. B — During periods of rising prices, LIFO matches the most recently purchased, higher-cost goods against revenue, producing a higher cost of goods sold, a lower ending inventory value, and lower taxable income than FIFO. FIFO instead leaves the oldest, lower-cost goods in cost of goods sold, resulting in higher taxable income.

41. C — Cost of goods sold equals beginning inventory plus purchases minus ending inventory. Here, $50,000 beginning inventory plus $200,000 in purchases equals $250,000 of goods available for sale. Subtracting the $60,000 ending inventory leaves $190,000 as the cost of goods sold reported on the business's federal income tax return for the year.

42. A — A cash-method taxpayer never recognized the unpaid amount as income when the services were rendered, since income is reported only when actually or constructively received. Because no income was ever included, there is no basis to recover through a bad debt deduction. The specific charge-off method applies only to previously reported income.

43. B — Nonbusiness bad debts, meaning loans unrelated to the taxpayer's trade or business, are always treated as short-term capital losses in the year the debt becomes wholly worthless, regardless of how long the debt was actually outstanding. No deduction is allowed for partial worthlessness, unlike business bad debts under the specific charge-off method.

44. D — Under Section 195, up to $5,000 of start-up costs is immediately deductible, but that amount is reduced dollar-for-dollar by costs exceeding $50,000. Since $53,000 exceeds the threshold by $3,000, the immediate deduction is reduced to $2,000, and the remaining $51,000 is amortized ratably over 180 months beginning when the business starts.

45. D — Section 248 allows corporations to immediately deduct up to $5,000 of organizational expenditures, reduced dollar-for-dollar for costs exceeding $50,000, with the remaining balance amortized ratably over 180 months starting with the month business begins. Here, $8,000 is well under the phase-out threshold, so the full $5,000 immediate deduction applies, and $3,000 is amortized.

46. A — Business meal expenses are generally limited to a 50% deduction, even if the meal is ordinary, necessary, and directly related to business, unless a specific exception applies, such as meals provided to the entire workforce at a company event or included in employee compensation. Here, no exception applies, so only half is deductible.

47. B — Adequate records for substantiating travel expenses under the accountable plan rules must document the amount, the time and place of travel, and the business purpose of the trip. The taxpayer's overall marginal tax rate has no bearing on substantiation and is not part of the recordkeeping requirement for these expenses.

48. C — Section 263A generally requires capitalization of both direct and indirect costs that benefit inventory production, including indirect costs such as factory storage, handling, and certain overhead. Selling, marketing, and distribution costs incurred after production, along with most research expenditures under Section 174, are excluded from the capitalization requirement and remain currently deductible business expenses.

49. D — Under the 12-month rule, a cash-method taxpayer may currently deduct a prepaid expense if the benefit does not extend beyond the earlier of 12 months after the right or benefit begins, or the end of the tax year following the year of payment. Since the coverage period does not exceed that window, the full amount is deductible in 2025.

50. C — Business gift deductions are limited to $25 per recipient per year, regardless of the actual cost of the gift. Even though each basket cost $40, only $25 per client is deductible, and incidental costs like engraving or packaging generally do not count toward this limitation if they do not add substantial value.

51. B — The mid-quarter convention applies to all personal property placed in service that year whenever more than 40% of the total depreciable basis is placed in service during the last three months. Here, $130,000 of $200,000 is 65%, well above the threshold, so the mid-quarter convention overrides the default half-year convention for every asset.

52. A — Section 179 expensing cannot exceed the taxpayer's aggregate taxable income from the active conduct of any trade or business. Because taxable income of $95,000 exceeds the $40,000 cost of qualifying equipment, the full purchase price is deductible in the current year, with no income limitation reduction and no amount carried forward.

53. C — Unlike Section 179, bonus depreciation under Section 168(k) is not limited by the taxpayer's business taxable income, so claiming it can generate or significantly increase a net operating loss for the year. Bonus depreciation applies automatically to qualifying property unless the taxpayer affirmatively elects out of it for a given class of property.

54. B — Listed property used partly for personal purposes is depreciated only on its business-use percentage of cost, and passenger automobiles remain subject to the annual luxury auto dollar limitations regardless of that percentage. Because business use here exceeds 50%, the taxpayer may still use accelerated MACRS rather than being forced into straight-line.

55. D — The Tax Cuts and Jobs Act repealed like-kind exchange treatment for personal property, restricting Section 1031 deferral exclusively to real property held for productive use in a trade or business or for investment. Because both buildings are real property exchanged for like-kind real property, gain on the exchange remains deferrable.

56. A — When Section 1231 gains and losses are netted for the year and the result is a net gain, that net amount is treated as long-term capital gain, subject to any five-year lookback recapture of prior nonrecaptured Section 1231 losses. A net loss, by contrast, is treated as an ordinary loss.

57. D — Section 1245 recaptures gain on the sale or disposition of depreciable personal property as ordinary income to the extent of depreciation previously claimed against it. Here, $35,000 of gain is fully absorbed by the $45,000 of accumulated depreciation, so the entire gain is ordinary recapture income rather than Section 1231 capital gain.

58. B — Because straight-line depreciation was consistently used throughout the holding period, there is no excess depreciation subject to ordinary income recapture under Section 1250. However, the portion of gain attributable to straight-line depreciation is unrecaptured Section 1250 gain, taxed as capital gain but capped at a special maximum rate rather than ordinary rates.

59. A — The general business credit is limited to the taxpayer's net income tax liability minus certain other credits, computed under the tentative minimum tax limitation. Any unused credit generally carries back one year and then forward up to twenty years, preserving the benefit rather than forfeiting it in a low-liability year.

60. C — The Work Opportunity Tax Credit requires the employer to obtain certification that the new hire belongs to a targeted group, such as long-term SNAP recipients, generally by timely submitting Form 8850 to the state workforce agency. Without this pre-screening and certification process, the wages paid do not qualify for the credit.

61. A — Section 41 generally provides a credit for increasing qualified research activities, computed based on qualified research expenses such as in-house wages, supplies, and certain contract research costs. This credit incentivizes technological innovation and process improvement, distinguishing it from hiring-based or accessibility-based credits available elsewhere in the general business credit family.

62. C — The QBI deduction generally equals the lesser of 20% of qualified business income or 20% of taxable income minus any net capital gain for the year. Here, 20% of $80,000 QBI is $16,000, and 20% of $90,000 taxable income is $18,000, so the smaller figure, $16,000, is the allowable deduction claimed.

63. D — Once a taxpayer's taxable income exceeds the applicable threshold, the QBI deduction for a non-SSTB business is limited to the greater of 50% of W-2 wages paid, or 25% of W-2 wages plus 2.5% of the unadjusted basis immediately after acquisition of qualified property, phased in gradually across the applicable income range.

64. B — Law is specifically listed under the tax code as a specified service trade or business. Once a taxpayer's taxable income exceeds the upper end of the phase-in range, the QBI deduction for an SSTB is completely eliminated, regardless of how much qualified business income the practice generates or how many wages it pays.

65. B — The business energy investment credit, part of the general business credit, rewards investment in qualifying renewable energy property such as solar equipment used in a trade or business. It is computed as a percentage of the property's cost and is distinct from employment-based or individual-taxpayer credits like WOTC or EITC.

66. D — The Social Security portion of FICA is 6.2 percent, withheld from wages and matched equally by the employer, but only up to the annual Social Security wage base. Medicare tax is a separate 1.45 percent with no wage cap. Together they form the 7.65 percent combined FICA rate applied below the wage base threshold.

67. A — Employers normally receive a 5.4 percent credit against the 6.0 percent FUTA rate, producing an effective 0.6 percent rate. States that borrow from the federal unemployment fund and fail to repay it become credit-reduction states, lowering the available credit. A 0.3 percent reduction raises the employer's effective FUTA rate to 0.9 percent for that state.

68. C — Behavioral control is a core factor in the common-law test. When a business dictates how, when, and where work is performed and directly supervises the process, it demonstrates the kind of control typical of an employer over an employee, rather than a client's limited oversight of an independent contractor's finished results.

69. B — Form SS-8 allows either a business or a worker to request an official IRS determination of whether a worker is an employee or an independent contractor for federal employment tax and income tax withholding purposes. The IRS reviews the facts and issues a determination letter, which the requesting party can then rely upon.

70. A — The simplified method lets a taxpayer deduct $5 per square foot of qualifying home office space, capped at 300 square feet, for a maximum deduction of $1,500. It replaces the need to track and allocate actual expenses such as utilities, insurance, and depreciation, though it may produce a smaller deduction than the regular method.

71. C — The home office deduction requires that a specific area of the home be used exclusively and regularly for business, with no substantial personal use permitted. Because the room also functions as a children's playroom on weekends, it fails the exclusive-use requirement, and no portion of the deduction may be claimed regardless of weekday business activity.

72. D — Employer-paid group-term life insurance is a deductible business expense, but the cost of coverage exceeding $50,000 must be included in the employee's taxable wages under IRC Section 79, using IRS Table I rates. The first $50,000 of coverage remains excludable to the employee, while the employer still deducts the full premium cost paid.

73. C — The general period of limitations for the IRS to assess additional tax is three years from the date a return is filed, so businesses should keep supporting records for at least that long. Longer retention, up to seven years, is advisable when a substantial understatement or a bad debt or worthless security deduction is involved.

74. D — A C corporation is a separate taxpayer and must make its own quarterly estimated tax payments if it expects to owe $500 or more. A partnership is a pass-through entity that generally does not pay entity-level income tax, so each partner is individually responsible for estimated payments on their allocated share of income.

75. B — A calendar-year partnership's Form 1065 is originally due March 15, the fifteenth day of the third month after the tax year ends. Filing Form 7004 grants an automatic six-month extension, moving the deadline to September 15. This earlier due date allows partners to receive their Schedule K-1 information before their own individual returns are due.

76. A — Under current law, most net operating losses can be carried forward indefinitely but cannot offset more than 80 percent of taxable income in the year the deduction is used. There is generally no carryback allowed for NOLs arising after 2020, except for certain farming losses and specified insurance company losses, which retain limited carryback rules.

77. B — Section 461(l) limits the amount of net business losses a noncorporate taxpayer may deduct against nonbusiness income in a single tax year. The disallowed excess is not lost permanently; instead, it is treated as part of the taxpayer's net operating loss and carried forward, subject to the NOL rules, to offset income in later years.

78. C — Section 163(j) generally caps the deduction for net business interest expense at business interest income plus 30 percent of adjusted taxable income, plus any floor plan financing interest. Interest expense disallowed under this limitation is not lost but may generally be carried forward indefinitely to future tax years, subject to the same annual limitation calculation.

79. A — Section 163(j) provides a small business exception for taxpayers, other than tax shelters, whose average annual gross receipts for the three prior tax years fall at or below the inflation-adjusted threshold. Qualifying businesses of any entity type, corporate or pass-through, are exempt from the interest expense limitation and need not track adjusted taxable income for this purpose.

80. D — An estate must file Form 1041 if it has gross income of $600 or more for the tax year, regardless of taxable income, or if any beneficiary is a nonresident alien. This threshold differs from the trust filing rule, which requires a return whenever a trust has any taxable income or $600 of gross income.

81. C — DNI limits how much of a distribution is taxed to beneficiaries rather than the trust and equals the maximum distribution deduction the fiduciary can claim. It also determines the character of amounts beneficiaries report, since DNI carries out the trust's or estate's income according to a proportionate share of each income type distributed.

82. A — A simple trust must distribute all income currently, may not make distributions of corpus, and cannot deduct amounts paid or set aside for charitable purposes. Any trust failing one of these three tests, such as accumulating income or distributing principal, is instead treated as a complex trust for the taxable year.

83. B — Retaining certain administrative powers, such as the power to reacquire trust assets by substituting property of equivalent value, triggers grantor trust status under Section 675. When a grantor trust exists, the trust's income, deductions, and credits flow through to the grantor's personal return instead of being reported and taxed at the trust level.

84. D — Organizations whose gross receipts are normally $50,000 or less may satisfy their annual filing obligation by submitting Form 990-N, the e-Postcard, rather than the full Form 990 or Form 990-EZ. Failing to file any required return for three consecutive years results in automatic revocation of tax-exempt status under Section 6033(j).

85. D — Income from a trade or business that is regularly carried on and not substantially related to an organization's exempt purpose is subject to unrelated business income tax, regardless of how the profits are ultimately used. The organization reports this income and computes the tax owed on Form 990-T, separate from its annual information return.

86. A — Private foundations are subject to a flat 1.39 percent excise tax on net investment income under Section 4940, which funds IRS oversight of exempt organizations. This tax applies regardless of whether the foundation also meets its minimum distribution requirement, and failing to pay it can jeopardize the foundation's continued tax-exempt status.

87. B — A defined benefit plan promises a specific retirement benefit calculated by a formula, typically based on salary and years of service, and the employer bears the investment risk of funding that promise. This contrasts with defined contribution plans, where the eventual benefit depends entirely on account balances built from contributions plus investment performance.

88. C — SEP IRA employer contributions are capped at the lesser of the annual dollar limit, $69,000 for 2024, or 25 percent of the employee's compensation. Unlike a SIMPLE IRA, a SEP requires only employer contributions, all participants must receive the same percentage, and employees cannot make elective salary deferrals into the plan.

89. D — Livestock held for draft, breeding, dairy, or sporting purposes are depreciable business assets rather than sale inventory, so gain or loss from their sale is reported on Form 4797 and may qualify for Section 1231 treatment. Raised market livestock held for resale, by contrast, is reported directly as Schedule F income.

90. C — Schedule J allows a farmer to elect to treat a portion of the current year's farm income as if it had been earned evenly across the three prior base years, recalculating tax at each base year's rates. This can lower total tax by taking advantage of lower brackets in years when income was smaller.

91. A — To qualify as a real estate professional, a taxpayer must perform more than half of all personal services in real property trades or businesses and more than 750 hours in those activities during the year, in addition to materially participating in each rental activity. Meeting these tests removes the automatic passive characterization of rental losses.

92. B — The Tax Cuts and Jobs Act limited Section 1031 like-kind exchange treatment to real property only, effective for exchanges completed after December 31, 2017. Farm equipment such as tractors, once eligible for deferral under prior law, is now personal property whose disposition is a fully taxable sale or exchange for federal purposes.

93. B — Closely held business interests are included in the gross estate at fair market value as of the date of death or the alternate valuation date, determined using accepted valuation methods. Because no public market exists, appraisers commonly apply discounts for lack of marketability and, where applicable, a minority-interest discount to reflect limited control.

94. D — Because a charitable remainder trust is tax-exempt, it can sell appreciated assets contributed to it without immediately triggering capital gains tax, allowing the full sale proceeds to be reinvested. The donor receives an income stream for a term or life plus a current charitable income tax deduction based on the remainder interest's value.

95. C — When distributions to multiple beneficiaries exceed DNI, each beneficiary reports a share of DNI proportionate to the amount that beneficiary actually received relative to the total distributed. This ensures the trust's total taxable income passed through to beneficiaries never exceeds DNI, with any excess distribution treated as a tax-free distribution of corpus.

96. A — Section 663(b) permits a trustee to elect to treat any distribution made within the first 65 days of a new tax year as though it were made on the last day of the preceding tax year. This 65-day rule gives fiduciaries added flexibility to manage DNI and reduce the trust's own taxable income after year-end.

97. A — Private foundations must annually distribute qualifying distributions at least equal to their minimum investment return, generally about 5 percent of the average fair market value of non-charitable-use investment assets. Falling short of this minimum distribution requirement triggers an excise tax under Section 4942, separate from the annual tax on net investment income.

98. B — Under the standard SIMPLE IRA formula, an employer generally matches employee elective deferrals dollar-for-dollar up to 3 percent of compensation, though the employer may instead elect a lower match, not below 1 percent, in no more than two of five years. Alternatively, the employer can make a 2 percent nonelective contribution for all eligible employees.

99. C — Every organization described in Section 501(c)(3) is presumed to be a private foundation unless it demonstrates that it qualifies for public charity status, such as by meeting a broad public support test or falling within another statutory exception. Private foundation classification subjects the organization to stricter excise taxes and operating restrictions.

100. D — Taxpayers who actively participate in rental real estate, without meeting the real estate professional standard, may deduct up to $25,000 of losses against nonpassive income each year. This special allowance phases out ratably for modified adjusted gross income between $100,000 and $150,000, disappearing entirely once income exceeds the upper threshold.