PRACTICE EXAM 16: 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. A partnership has three partners: Partner X (calendar year, 50% interest), Partner Y (calendar year, 30% interest), and Partner Z (June 30 fiscal year, 20% interest). Under the majority-interest taxable year rule, what tax year must the partnership adopt?

A. Calendar year, because partners owning more than 50% of profits and capital share that same tax year
B. June 30 fiscal year end, matching the highest single ownership percentage partner
C. A year determined solely by the partnership representative's discretion
D. September 30, using the deferral period closest to three months

2. On July 1, a partner sells half of her 40% partnership interest to a new partner mid-year, changing the ownership percentages for the remainder of the year. Under Section 706(d), how must the partnership's income for the year be allocated between the transferor and the transferee?

A. All income for the entire year is allocated to the transferee, since she now holds the interest
B. The partnership may allocate the full year's income however the partners agree, without restriction
C. Income is allocated entirely to the transferor because she held the interest for more of the year

D. Income must be allocated based on each partner's varying interest during the periods before and after the transfer, using an interim closing or proration method

3. A partner sells her 25% partnership interest for a gain. The partnership holds unrealized receivables from services already performed but not yet billed. How must the portion of the gain attributable to those unrealized receivables be treated?

A. As a capital gain, since the entire interest sold is a capital asset

B. As tax-exempt income, because the receivables have not yet been collected

C. As ordinary income under Section 751, requiring the seller to recharacterize that portion of the gain

D. As a Section 1231 gain eligible for preferential long-term capital gain rates

4. A partnership distributes property to a partner in a nonliquidating distribution. The property had an inside basis of $30,000 to the partnership. What basis does the partnership take in any property it retains, and how does the distribution generally affect the basis of the distributed property to the recipient partner?

A. The partnership must recognize gain on the distribution equal to the property's fair market value

B. The distributed property generally carries over the partnership's inside basis, limited to the partner's outside basis in the interest.

C. The distributed property automatically takes a fair market value basis in the partner's hands

D. The partnership's retained assets must be written down dollar-for-dollar by the distributed property's basis

5. A partner contributes land held for four years as an investment to a partnership in exchange for a partnership interest. For purposes of determining the partner's holding period in the partnership interest received, what rule applies?

A. The holding period begins fresh on the date of contribution, disregarding the partner's prior ownership

B. The holding period is always short-term regardless of how long the partner owned the land

C. The holding period is determined only by the partnership's holding period in its other assets

D. The partner's holding period in the contributed land tacks onto the partnership interest received, since it was a capital asset.

6. A partnership incurs costs for printing and distributing a prospectus to solicit investors to purchase interests in the partnership. How are these syndication costs treated for tax purposes?

A. They are deductible in full in the year paid as ordinary business expenses

B. They are neither deductible nor amortizable, unlike organizational costs, which may be partially deducted and the remainder amortized

C. They must be amortized over exactly 15 years like intangible assets under Section 197

D. They are added to the basis of the partnership's depreciable property and recovered through depreciation

7. A partner determines that her partnership interest has become completely worthless because the partnership has no remaining assets, no prospect of future value, and she has no obligation to contribute further capital. She takes no affirmative step to dispose of the interest. How is this loss generally treated?

A. As a loss from worthlessness, deductible in the year the interest is shown to have no value or recovery prospect.

B. No loss may ever be claimed without a sale to an unrelated third party

C. The loss must be treated as a capital contribution reversal with no tax effect

D. The loss is automatically converted into ordinary income to the partnership

8. A partnership has both recourse debt, for which one general partner bears the ultimate economic risk of loss, and nonrecourse debt secured by property with no personal guarantees. How does the method for allocating each type of liability among the partners' outside bases generally differ?

A. Both types of debt are always allocated equally among all partners regardless of risk or ownership

B. Recourse and nonrecourse debt are both allocated strictly according to profit-sharing ratios with no other test applied

C. Recourse debt is allocated based on which partner bears the economic risk of loss, while nonrecourse debt is generally allocated based on profit-sharing ratios and minimum gain rules

D. Nonrecourse debt is allocated entirely to the general partner, while recourse debt is allocated entirely to the limited partners

9. A limited partner's outside basis in her partnership interest is $40,000, but her amount at risk under Section 465 is only $15,000 because a portion of her basis comes from nonrecourse financing for which she has no personal exposure. If her distributive share of the partnership's loss for the year is $25,000, how much of that loss may she currently deduct?

A. The full $25,000, since outside basis is the only limitation that applies to loss deductions
B. Zero, because at-risk rules disallow any loss deduction for limited partners
C. $40,000, because basis and at-risk amount are combined for the deduction limit
D. Only $15,000, with the remaining $10,000 suspended and carried forward until her at-risk amount increases

10. Partnership A is itself a partner in Partnership B, forming a tiered partnership structure. How does income earned by Partnership B generally flow through to the ultimate individual partners of Partnership A?

A. Income stops at Partnership B and is taxed only at the entity level before reaching Partnership A
B. Income, deductions, and credits pass through Partnership B to Partnership A, retaining their character, and then pass through Partnership A to its individual partners
C. Income is converted to dividend income once it reaches the upper-tier partnership
D. Each tier may elect to be taxed as a separate corporation to avoid multiple layers of pass-through

11. Two partnerships combine their operations, with one partnership's assets and liabilities merging into the other under Section 708(b)(2). Under the general default rule, how is the resulting merger treated for tax purposes?

A. The partnership receiving over 50% of interests continues, while the other partnership is treated as terminating and contributing its assets.
B. Both partnerships are always treated as terminating simultaneously, with a brand-new partnership formed from scratch
C. Neither partnership is treated as terminating, regardless of relative ownership after the merger

D. The merger is disregarded entirely for tax purposes and treated as a nontaxable reorganization

12. A joint operating arrangement among co-owners of investment property meets all requirements for excluding the venture from partnership tax treatment. What is the effect of a valid election out of subchapter K under Section 761(a)?

A. The co-owners are still required to file a partnership return but each reports income separately as a memo item

B. The election automatically converts the arrangement into an S corporation for tax purposes

C. The election is available to any partnership regardless of its business purpose or activities

D. Each co-owner reports his or her proportionate share of income, deductions, and credits directly on an individual return, without partnership-level filing or the entity-level rules of subchapter K applying

13. A married couple who resides in a community property state jointly operates a business as the sole members treated as a partnership for federal tax purposes, with no employees other than themselves. Which statement best describes the federal tax treatment available to them?

A. They must always file as a C corporation once married, regardless of state law

B. They are prohibited from ever being treated as a partnership under any circumstances

C. They may elect qualified joint venture treatment to report the business on separate Schedule Cs, since both spouses co-own and operate it.

D. Community property law requires them to split all income equally on two separate partnership returns

14. Under the BBA centralized partnership audit regime, the IRS examines a partnership's return for a prior year and proposes adjustments. What role does the partnership representative play in this process?

A. The partnership representative has no legal authority and merely observes the audit on behalf of the partners

B. The partnership representative has sole authority to bind the partnership and all its partners in the audit, including agreeing to adjustments, without needing individual partner consent

C. Each partner individually negotiates directly with the IRS, and the representative's role is purely ceremonial

D. The partnership representative must be a current partner and cannot be a third-party professional

15. In exchange for future services to be performed, a new partner receives a partnership interest that entitles her to a share of the partnership's existing capital if the partnership were liquidated immediately. How is the receipt of this capital interest treated for tax purposes?

A. The fair market value of the capital interest received is taxable compensation income to the partner in the year of grant, and the partnership generally receives a corresponding deduction

B. The receipt is entirely tax-free because it was received in exchange for services rather than cash

C. Taxation is deferred indefinitely until the partner actually sells the partnership interest

D. The capital interest is treated the same as a profits interest and is never currently taxable under Rev Proc 93-27

16. A partnership accrues a guaranteed payment owed to a cash-basis partner for services rendered in December, but does not actually pay the amount to the partner until the following January. Assuming the partnership uses the accrual method, when does the partnership deduct the payment, and when must the partner include it in income?

A. Both the deduction and the income inclusion occur in January, when cash actually changes hands

B. Neither party recognizes the payment until the partnership terminates

C. The partnership deducts the payment under its own accounting method; the partner reports it in the partnership's corresponding tax year.

D. The partner must include the payment in income before the partnership is entitled to any deduction, regardless of either party's accounting method

17. A partnership fails the majority-interest taxable year test because no group of partners owning more than 50% of profits and capital shares the same tax year. The partnership next applies the principal partners test, but that test also fails to identify a required year. Which method must the partnership use to determine its required tax year?

A. The least-aggregate-deferral method, which calculates the tax year that produces the smallest total deferral of income across all partners

B. The partnership may choose any tax year it wishes without further testing

C. The partnership must default to a calendar year regardless of the deferral calculated

D. The partnership must liquidate and reform in order to select a permissible year

18. A partner sells her entire partnership interest. The partnership's inventory has a fair market value substantially in excess of its tax basis, meeting the threshold to be classified as substantially appreciated inventory under Section 751. What is the tax consequence of this classification?

A. Substantially appreciated inventory has no effect on the character of gain from selling a partnership interest

B. The inventory must be distributed in kind before the sale can be treated as a partnership interest sale

C. Only inventory that has already been sold by the partnership triggers this rule

D. The portion of the partner's gain attributable to the substantially appreciated inventory is treated as ordinary income rather than capital gain, under the Section 751 hot asset rules

19. Maple Corp, an S corporation, has two classes of common stock: Class A shares carry voting rights and Class B shares are nonvoting, but both classes have identical rights to distributions and liquidation proceeds. Under the S corporation one-class-of-stock requirement, this capital structure is:

A. Prohibited, because any distinction between share classes automatically creates a second class of stock

B. Prohibited, because voting rights differences are treated the same as distribution rights differences

C. Permitted, because differences in voting rights are allowed as long as distribution and liquidation rights are identical

D. Permitted only if the nonvoting shares are held exclusively by trusts or estates

20. Diane, a 40% shareholder in an S corporation, personally guarantees a $50,000 bank loan made directly to the corporation. The corporation makes all payments on the loan, and Diane never advances any of her own funds. For purposes of increasing Diane's basis to allow her to deduct pass-through losses, this guarantee:

A. Increases Diane's stock basis dollar-for-dollar as soon as the guarantee is signed

B. Does not create debt basis, because a mere guarantee is not a bona fide direct loan from the shareholder to the corporation

C. Increases Diane's debt basis only if the corporation is later dissolved

D. Increases Diane's debt basis automatically once the loan balance exceeds her stock basis

21. Before a redemption, Marcus owned 400 of a corporation's 1,000 outstanding shares (40%). The corporation redeems 150 of his shares, leaving 850 shares outstanding, of which Marcus now owns 250 (approximately 29.4%). To qualify as a substantially disproportionate redemption eligible for sale (exchange) treatment rather than dividend treatment, which condition must be met?

A. Marcus must own less than 50% of the corporation both before and after the redemption

B. Marcus must terminate his entire interest in the corporation immediately after the redemption

C. After the redemption, Marcus's percentage ownership must be less than 80% of his pre-redemption percentage, and he must own less than 50% of total voting power

D. The corporation must distribute cash equal to at least 20% of its accumulated earnings and profits

22. Acquiring Corp obtains all of Target Corp's outstanding voting stock solely in exchange for Acquiring Corp's own voting stock; Target continues to exist as a subsidiary of Acquiring Corp, and no cash or other property is used in the exchange. This structure describes which type of tax-free corporate reorganization?

A. A Type A statutory merger, because the two corporations combine under state merger law

B. A Type B stock-for-stock acquisition, because voting stock alone is exchanged for control of the target's stock

C. A Type C stock-for-assets acquisition, because Acquiring Corp obtains substantially all of Target's assets

D. A Type D divisive reorganization, because Target's shareholders end up with stock in two entities

23. Five or fewer individuals own more than 50% (taking into account each individual's identical ownership across entities) and at least 80% of the total voting power or value of both Corporation X and Corporation Y. Corporations X and Y are best described as:

A. A brother-sister controlled group, which generally must share a single set of tax brackets and certain dollar limits among the group

B. A parent-subsidiary controlled group, because one corporation owns a majority interest in the other

C. An affiliated group eligible to file a consolidated return automatically, with no election required

D. Unrelated corporations, because controlled group rules apply only when one corporation owns stock in the other

24. Robert owns 5% of the stock of an S corporation and works full-time as an employee. The corporation pays Robert's health insurance premiums under a group plan. How must this benefit generally be treated for tax purposes?

A. It is fully excludible from Robert's income in the same manner as for a rank-and-file employee

B. It is deductible by the corporation but has no effect on Robert's Form W-2 at all

C. It is treated as a nondeductible corporate expense with no reporting to Robert

D. Because Robert owns more than 2% of the corporation, the premiums are generally taxable to him and must be added to his W-2 wages

25. A C corporation with $500,000 of taxable income (computed before the charitable contribution deduction and certain other adjustments) makes a $75,000 cash contribution to a qualified public charity during the year. How much of the contribution may the corporation deduct in the current year, and what happens to any excess?

A. The full $75,000 is deductible in the current year, with no limitation for corporate donors

B. Only $25,000 is deductible, and the excess is permanently lost with no carryforward

C. The deduction is limited to 10% of taxable income ($50,000), and the remaining $25,000 may generally be carried forward

D. The deduction is limited to 50% of taxable income, matching the individual charitable contribution limit

26. Corporation P owns a small minority interest (less than 20%) in unrelated Corporation Q and receives a $10,000 dividend from Corporation Q during the year. Which of the following best describes the tax treatment available to Corporation P?

A. The entire $10,000 dividend is excluded from Corporation P's gross income automatically

B. Corporation P must include the dividend in income with no offsetting deduction available

C. Corporation P may deduct the dividend only if it owns at least 80% of Corporation Q

D. Corporation P may generally claim a dividends-received deduction, reducing the effective tax on the dividend to mitigate multiple layers of corporate taxation

27. A traditional corporate alternative minimum tax applied to most C corporations before it was repealed for tax years beginning after 2017. Under current law, which statement about corporate alternative minimum tax is accurate?

A. A Corporate Alternative Minimum Tax now applies only to certain large "applicable corporations" that meet specified average financial statement income thresholds

B. The corporate alternative minimum tax was fully repealed and no version of it applies to any corporation today

C. The corporate alternative minimum tax now applies to every C corporation regardless of size

D. The corporate alternative minimum tax was replaced entirely by the accumulated earnings tax for all corporations

28. A C corporation generates a net operating loss in a post-2017 tax year and carries it forward to a later profitable year. In the carryforward year, how much of the corporation's taxable income may generally be offset by that NOL carryforward?

A. Up to 100% of taxable income in the carryforward year, with no percentage cap

B. Up to 80% of taxable income in the carryforward year, computed before the NOL deduction itself

C. Up to 50% of taxable income, matching the pre-2017 rule that still applies to all losses

D. None of the loss may be carried forward; post-2017 NOLs may only be carried back

29. An S corporation's sole shareholder-employee performs substantial services for the business but pays himself a salary of only $15,000 per year while taking $150,000 in annual distributions, despite comparable employees in similar roles earning far more in wages. What is the primary IRS concern with this arrangement?

A. The IRS will disregard the S election entirely and tax the entity as a C corporation

B. The IRS may recharacterize a portion of the distributions as wages subject to payroll taxes, since compensation for services must be reasonable

C. The arrangement is always permissible as long as total compensation and distributions combined equal fair market value
D. The IRS only scrutinizes compensation levels for S corporations with more than one shareholder

30. A licensed architect is choosing between organizing her practice as a professional corporation (PC) and a professional limited liability company (PLLC). Which statement best distinguishes the two entity choices available to licensed professionals?

A. A PLLC is not permitted to make an S election, while a PC must always be taxed as a C corporation
B. Only a PC provides any liability protection for the professional's own malpractice, while a PLLC provides none
C. Both entity types generally shield owners from the business debts and malpractice of other owners, but neither shields a professional from liability for their own malpractice
D. A PLLC requires state licensing board approval while a PC does not require any professional licensing

31. A real estate investor forms a single LLC that establishes internally segregated series, each holding a different rental property, with separate books and records maintained for each series. Assuming the state's statute is properly followed, what is the primary benefit of this series LLC structure?

A. Each series can generally maintain its own liability shield, so a claim against one property's series does not expose the assets held in other series
B. All series are automatically taxed as a single consolidated C corporation regardless of state law
C. A series LLC eliminates the need to file any separate state formation documents for the parent LLC
D. Each series must have identical ownership and identical business purposes as every other series

32. Acquiring Corp obtains substantially all of Target Corp's assets solely in exchange for Acquiring Corp's voting stock; Target then distributes the stock it received (along with any remaining assets) to its shareholders and dissolves. This structure most closely describes which type of tax-free reorganization?

A. A Type A statutory merger, because Target ceases to exist under state law
B. A Type B stock-for-stock acquisition, because voting stock is the consideration used
C. A divisive reorganization, because the transaction splits Target into multiple surviving entities

D. A Type C stock-for-assets acquisition, since the acquirer obtains substantially all of Target's assets primarily for voting stock.

33. Sandra owns 30% of a corporation's outstanding stock. The corporation redeems all of Sandra's shares in a single transaction, and Sandra has no remaining stock ownership, no continuing role as an officer or director, and no family attribution that would be treated as continued ownership. How is this redemption most likely treated?

A. As a dividend to Sandra, taxed as ordinary income up to the corporation's earnings and profits
B. As a partially taxable event, with half treated as sale proceeds and half as dividend income
C. As a complete termination of Sandra's interest, qualifying for sale or exchange (capital gain) treatment
D. As a tax-free reorganization, since Sandra's entire interest was eliminated in one transaction

34. An S corporation's governing documents provide that half of its shareholders receive distributions at a higher rate per share than the other half, although all shares carry identical voting rights. What is the effect of this arrangement on the corporation's S election?

A. It has no effect, because only differences in voting rights can create a second class of stock
B. It is permitted as long as the disparity is disclosed to the IRS in advance
C. It is permitted, because distribution timing differences are treated differently from distribution amount differences
D. It violates the one-class-of-stock requirement, because differing rights to distributions create a second class of stock and can terminate the S election

35. Parent Corp owns 90% of the total voting power and total value of Subsidiary Corp's outstanding stock. Parent Corp and Subsidiary Corp are best described as:

A. A parent-subsidiary controlled group, because one corporation owns at least 80% of another corporation in the chain
B. A brother-sister controlled group, because common individual owners hold the requisite ownership in both corporations
C. An unrelated group of corporations, since only one corporation owns stock and the other does not

D. A combined group only if the two corporations also file a consolidated federal income tax return

36. A sole proprietor operates a small breeding and training business alongside a full-time job. To rely on the rebuttable presumption under Section 183 that the activity is engaged in for profit rather than as a hobby, the activity generally must show a profit in at least how many of the last five tax years?

A. 1 of the last 5 tax years
B. 3 of the last 5 tax years
C. 4 of the last 5 tax years
D. 5 of the last 5 tax years

37. A business owner purchases tickets to a professional football game and takes a client to the game to discuss a potential contract. Under current law following the Tax Cuts and Jobs Act, what is the deductibility of the cost of the game tickets?

A. Nondeductible in full, regardless of business purpose
B. Deductible in full because the purpose was business-related
C. Deductible at 50%, the same as a business meal
D. Deductible at 50% only if a written agenda is kept

38. An employer wants to give a long-service employee a tangible personal property award for 20 years of service, excludable from the employee's income and deductible by the employer up to certain limits. Which of the following best describes what such an award must be to qualify as a deductible, excludable employee achievement award?

A. Paid in cash or a cash-equivalent gift card to the employee
B. Awarded only during the employee's initial probationary period of employment
C. Valued in excess of one thousand six hundred dollars per employee
D. Tangible personal property for length-of-service or safety, within IRS dollar caps

39. A corporation pays a lobbyist to influence pending federal legislation that would affect its industry. How are these lobbying expenditures generally treated for federal income tax purposes?

A. Fully deductible as ordinary and necessary business expenses
B. Deductible at 50%, similar to business meals
C. Nondeductible, regardless of the business connection to the legislation
D. Deductible only if the legislation is enacted into law

40. A business is assessed and pays a penalty to a state environmental agency for violating a pollution control statute. How is this penalty treated on the business's federal income tax return?

A. Deductible in full as an ordinary cost of business
B. Nondeductible, since it was paid to a government for a legal violation
C. Deductible at half its amount as a compliance expense
D. Deductible only if the violation was found to be unintentional

41. A corporation purchases a life insurance policy on its president, naming the corporation itself as the beneficiary, to protect against the financial loss of losing a key employee. How are the premiums paid on this policy treated?

A. Nondeductible, because the corporation is directly or indirectly a beneficiary
B. Fully deductible as an ordinary business insurance expense
C. Deductible at 50%, similar to business meal expenses
D. Deductible only in the year the president retires

42. A business owner pays annual membership dues to a country club, primarily using the membership to entertain clients on the golf course. How are these club dues treated for federal income tax purposes?

A. Deductible in full as a client-entertainment expense
B. Nondeductible, since club dues for pleasure or recreation are barred by statute
C. Deductible at 50%, the same as business meals
D. Deductible only if the club is used exclusively for business meetings

43. A retail business's storefront and inventory are destroyed by a severe storm that is not designated a federally declared disaster. Under current post-TCJA rules, what is the treatment of this casualty loss for the business?

A. Fully deductible, since casualty loss limits do not apply to businesses
B. Nondeductible, since casualty loss deductions were entirely repealed by the TCJA
C. Not deductible, since the loss occurred outside a federally declared disaster area
D. Deductible at half, the same limitation that applies to business meal costs

44. A taxpayer exchanges business real property with a fair market value of $500,000 for another business real property worth $450,000, plus $50,000 cash. Assuming the exchange otherwise qualifies as like-kind under Section 1031, how is the $50,000 cash treated?

A. It is entirely tax-deferred along with the real property
B. It reduces the basis of the property given up
C. It is treated as a tax-free return of capital
D. It is boot, taxed as gain to the extent of the cash

45. An accrual-method business wants to deduct a liability for services received but not yet paid for. Under the all-events test, what must occur, in addition to economic performance, before the liability may be deducted?

A. The business must actually pay the liability in cash by year-end
B. The liability must be satisfied in full within thirty days of year-end
C. The fact of the liability must be fixed, and the amount determinable with reasonable accuracy
D. The liability must instead be reported on a cash-basis tax return

46. An accrual-method manufacturer accrues a liability at year-end for repair services to be performed by an outside contractor. When does economic performance occur for this type of liability, allowing the related deduction (subject to the recurring-item exception)?

A. When the liability is first recorded on the company's books

B. When the repair contract is executed and signed
C. When the manufacturer pays the outside contractor's invoice
D. When the outside contractor actually performs the repair work

47. A C corporation that has used the LIFO inventory method elects to become an S corporation effective for the next tax year. What special tax is triggered by this election with respect to the LIFO inventory?

A. LIFO recapture tax, based on the excess of FIFO value over LIFO value
B. Section 481(a) adjustment, spread evenly over four tax years
C. A one-time excise tax equal to 10% of gross receipts
D. No special tax applies, since S corporations may not use inventory at all

48. A business wants to change its method of valuing inventory from FIFO to a different acceptable method for the upcoming tax year. What must the business generally do before making this change?

A. Simply begin using the new method on the next tax return filed
B. Obtain the consent of the IRS, generally by filing Form 3115
C. Amend the three most recently filed tax returns
D. Notify only the taxpayer's state department of revenue

49. A retail business is evaluating whether it must apply the uniform capitalization (UNICAP) rules under Section 263A to its inventory costs. Which of the following exempts a business from applying UNICAP, regardless of its industry?

A. Being organized as a sole proprietorship instead of a corporation
B. Employing fewer than ten full-time employees during the year
C. Meeting the average annual gross receipts threshold over the prior three years
D. Purchasing all of its inventory from a single supplier

50. A self-employed attorney pays annual dues to the state bar association, which are required to maintain her license to practice law. How are these professional dues treated for federal income tax purposes?

A. Deductible as an ordinary and necessary business expense
B. Nondeductible, since bar dues are treated the same as club dues
C. Deductible at 50%, the same as business meals
D. Deductible only if paid directly by a client on her behalf

51. For the 2025 tax year, a business owner purchased and placed in service $3,050,000 of qualifying Section 179 property for use in her sole proprietorship. Before applying any income limitation, how does this purchase amount affect her maximum allowable Section 179 deduction?

A. The deduction is unaffected because Section 179 has no dollar cap for property placed in service after 2017
B. The deduction is capped only by the mid-quarter convention because total purchases exceeded the safe harbor
C. The deduction is reduced to zero because total qualifying purchases exceed the annual investment ceiling entirely
D. The maximum allowable deduction is reduced dollar-for-dollar once purchases exceed the annual phase-out threshold amount

52. A retail business spent $400,000 renovating the interior of a leased retail building it has occupied for six years. The renovation did not enlarge the building, and no elevator or escalator work was involved. How is this qualified improvement property generally treated for depreciation purposes?

A. It must be depreciated over 39 years and is entirely ineligible for any bonus depreciation election
B. It is depreciated over a 15-year recovery period and is eligible for bonus depreciation if elected
C. It is depreciated over 27.5 years because interior renovations follow residential rental property rules exactly
D. It is expensed immediately in full under repair regulations without any capitalization requirement whatsoever applying

53. A corporation acquired a competitor's business, and $1,500,000 of the purchase price was allocated to goodwill and going-concern value. For federal income tax purposes, how must the corporation recover the cost of these acquired intangible assets?

A. Amortized straight-line over 15 years under Section 197, regardless of the assets' actual useful life
B. Depreciated over 39 years using the same convention applied to nonresidential real property acquisitions
C. Deducted immediately in the year of acquisition as an ordinary and necessary business expense
D. Never recovered for tax purposes because goodwill is treated as a nondepreciable capital asset always

54. A taxpayer sold fully depreciated business equipment in an installment sale, with payments to be received over five years. The sale resulted in $60,000 of depreciation recapture under Section 1245. When must this recapture income be reported?

A. Spread evenly over the five-year payment period using the same ratio as the installment gain
B. Deferred entirely until the final installment payment is received from the buyer in year five
C. Reported only in years when cash payments actually exceed the taxpayer's remaining adjusted basis amount
D. Recognized in full in the year of sale, regardless of when installment payments are actually received

55. A small business with 25 employees and $800,000 in prior-year gross receipts spent $12,000 installing a wheelchair ramp and accessible restroom fixtures to comply with accessibility requirements. Which credit is specifically designed to offset costs like these?

A. The Work Opportunity Tax Credit for hiring employees from targeted disadvantaged groups facing employment barriers
B. The Research and Development Credit for qualified expenditures related to experimentation and technological improvement
C. The Disabled Access Credit claimed on Form 8826 for eligible small business accessibility expenditures
D. The Low-Income Housing Credit allocated by state agencies for qualified affordable rental housing projects

56. An employer adopted a written policy providing at least two weeks of paid family and medical leave annually to all qualifying employees, paying at least 50% of normal wages during the leave. Which credit may this employer potentially claim under Section 45S?

A. The Work Opportunity Tax Credit, since paid leave policies satisfy the targeted-group hiring requirement automatically

B. The employer credit for paid family and medical leave, based on a percentage of wages paid

C. The Section 45R credit for small employer health insurance premiums paid on behalf of employees

D. The energy efficient commercial buildings deduction, since the policy reduces overall facility operating costs

57. A partnership invested in a qualified affordable housing development and received an allocation of tax credits from the state housing agency based on the project's qualified basis. What best describes this credit's general purpose and administration?

A. It reimburses employers dollar-for-dollar for wages paid to employees called to active military duty

B. It rewards businesses for qualified research expenditures that exceed a calculated base amount threshold

C. It offsets accessibility modification costs incurred by small businesses under a fixed statutory percentage

D. It encourages construction or rehabilitation of affordable rental housing through credits claimed over several years

58. A qualifying small employer with fewer than 25 full-time equivalent employees and average annual wages below the statutory threshold purchased health coverage for its employees through the SHOP marketplace. Which credit specifically rewards this arrangement?

A. The Disabled Access Credit, because health coverage purchases are treated as accessibility-related expenditures

B. The Work Opportunity Tax Credit, because the employees hired qualify under a targeted group category

C. The Section 45R credit for small employer health insurance premiums paid through a qualifying exchange

D. The energy efficient commercial buildings deduction, because employee wellness reduces facility energy consumption costs

59. A business owner continued paying an employee's regular salary while that employee was on active duty with the National Guard, even though the employee received lower military pay during the deployment period. Which credit may compensate the employer for this wage differential?

A. The Research and Development Credit, since retaining trained employees preserves institutionalized technical knowledge
B. The differential wage payment credit for compensation paid to employees on qualified active military duty
C. The Low-Income Housing Credit, since continued employment supports household income stability during deployment
D. The general business credit ordering rule, which applies broadly to any wage continuation arrangement

60. A commercial building owner installed a new energy-efficient lighting, HVAC, and building envelope system that reduced total annual energy and power costs by more than the statutory percentage required under the applicable federal standard. What tax benefit may the owner claim?

A. A deduction under Section 179D for energy efficient commercial building property meeting statutory savings thresholds
B. A credit under Section 45R because energy-efficient upgrades are treated identically to health coverage costs
C. The Work Opportunity Tax Credit, since energy contractors hired often qualify under a targeted group
D. The Disabled Access Credit, because energy-efficient systems are classified as accessibility improvements under regulations

61. A taxpayer operates two separate trades or businesses that share centralized accounting, common ownership, and overlapping customer bases, but that individually generate modest QBI amounts. What election might allow the taxpayer to combine these businesses for QBI deduction purposes?

A. The Section 179 election, which allows combining multiple businesses' asset purchases into one deduction limit

B. The installment sale election, which allows combining gain recognition across multiple related business activities

C. The like-kind exchange election, which allows combining basis from multiple business properties transferred jointly

D. The QBI aggregation election, which allows combining multiple qualifying trades or businesses meeting the requirements

62. A taxpayer received dividends from a real estate investment trust and income from a publicly traded partnership during the tax year. How is this income generally treated for purposes of the QBI wage and UBIA limitation applicable to high-income taxpayers?

A. REIT dividends and qualified PTP income are not subject to the wage and UBIA limitation at all

B. REIT dividends and PTP income are always fully disallowed once taxable income exceeds the upper threshold

C. REIT dividends and PTP income are treated identically to SSTB income and phased out completely

D. REIT dividends and PTP income are limited to 20% of wages paid by the underlying entity

63. A corporation is eligible in the same tax year to claim components of the Work Opportunity Tax Credit, the Research and Development Credit, and the Disabled Access Credit, all combined into the general business credit. In what order are these credit components generally applied against tax liability?

A. Components are applied entirely at random, since the Internal Revenue Code sets no statutory ordering rule

B. Components are applied in the order listed on Form 3800 following the statutory ordering rules

C. Components are applied based solely on which credit generates the largest total dollar amount claimed

D. Components are applied only after all carryforward amounts from prior years have been fully exhausted

64. A business placed a new passenger automobile in service during 2025 and wants to know the maximum first-year depreciation deduction allowed under the luxury automobile limits, assuming bonus depreciation applies. Why must the practitioner check the specific placed-in-service year before answering?

A. Luxury auto limits apply only to vehicles purchased for cash and never to financed or leased vehicles

B. Luxury auto limits were permanently repealed for all passenger automobiles placed in service after 2017

C. The dollar caps are indexed for inflation and published annually, so they vary by placed-in-service year

D. The dollar caps depend entirely on the taxpayer's filing status rather than the vehicle's service date

65. A business purchased a heavy pickup truck with a manufacturer-rated gross vehicle weight of 6,800 pounds and used it 100% for business deliveries. How does Section 280F's depreciation limitation treat this vehicle differently from a standard passenger automobile?

A. The truck is subject to identical dollar caps as passenger automobiles because both are road vehicles

B. The truck is entirely ineligible for depreciation because heavy vehicles are excluded from all cost recovery

C. The truck is exempt from the passenger automobile depreciation caps due to its gross vehicle weight

D. The truck must use straight-line depreciation exclusively regardless of any other elections available otherwise

66. An employee working for a single employer receives wages of $215,000 during the calendar year. Which statement correctly describes the employer's Additional Medicare Tax withholding obligation?

A. Withholding applies only if the employee files a written request for extra tax withholding

B. The employer must match the 0.9% Additional Medicare Tax the same way it matches regular Medicare tax

C. The employer must withhold the additional 0.9% starting with the employee's very first wage payment

D. The employer must withhold an additional 0.9% on wages exceeding $200,000, with no matching employer share

67. A business pays an independent contractor $3,000 during the year for services, but the contractor fails to provide a valid Taxpayer Identification Number on Form W-9 despite the payer's request. What is the payer generally required to do?

A. Withhold federal income tax at the contractor's marginal individual tax rate on the full payment
B. Begin backup withholding at a flat 24% rate on future reportable payments to the contractor
C. Refuse to make any further payments to the contractor until the IRS issues a written notice
D. Withhold Social Security and Medicare tax on the payment as if the contractor were an employee

68. Which statement correctly describes Form 941, Employer's Quarterly Federal Tax Return?

A. It reports withheld income tax plus the employer's and employees' shares of Social Security and Medicare tax
B. It reports only the employer's share of federal unemployment tax owed for the preceding calendar quarter
C. It is filed annually by every employer to reconcile total wages paid against Forms W-2 issued
D. It is used exclusively by employers who elect to pay household employment taxes on a quarterly schedule

69. An employer's payroll tax deposit schedule (monthly or semiweekly) for a given calendar year is determined by which factor?

A. The employer's total gross receipts reported on the prior year's income tax return
B. Whether the employer pays wages weekly, biweekly, semimonthly, or monthly to its employees
C. An irrevocable election made by the employer on the original Form SS-4 application
D. The total employment tax liability reported during the lookback period established by the IRS

70. An employer deposits its federal payroll taxes 20 calendar days after the due date, without having received a prior IRS delinquency notice. Under the tiered federal deposit penalty structure, what penalty rate generally applies?

A. 10% of the underpayment, the rate applying to deposits made 16 or more days late
B. 2% of the underpayment, the rate applying to deposits made 1 to 5 days late
C. 5% of the underpayment, the rate applying to deposits made 6 to 15 days late
D. 15% of the underpayment, the rate applying to amounts unpaid 10 days after an IRS notice

71. A calendar-year S corporation wants to file its income tax return on time. Absent an extension, what is the due date, and how much additional time does a timely filed extension provide?

A. April 15, with a 6-month extension available to October 15
B. March 15, with a 6-month extension available to September 15
C. March 15, with a 3-month extension available to June 15
D. April 15, with a 3-month extension available to July 15

72. A calendar-year C corporation is preparing its annual income tax return. What is the unextended due date for Form 1120?

A. March 15, the same date that applies to partnerships and S corporations
B. September 15, six months after the close of the corporation's fiscal year
C. April 15, the fifteenth day of the fourth month after year-end
D. October 15, the extended due date rather than the original due date

73. Under an accountable plan for employee business expense reimbursements, which condition must be satisfied for reimbursements to be excluded from the employee's taxable wages?

A. The employee must report the reimbursement as income and later claim an offsetting deduction
B. The employer must reimburse expenses using a flat monthly allowance regardless of actual spending
C. The employee may retain any reimbursement received in excess of substantiated business expenses
D. The employee must substantiate expenses and return any excess reimbursement within a reasonable time

74. An employer reimburses employees for business travel lodging and meal costs using the IRS high-low per diem substantiation method instead of actual expense receipts. What does this method require the employee to substantiate?

A. Only the total dollar amount spent on lodging, since meals are automatically deemed substantiated

B. Nothing at all, since the high-low rate itself fully satisfies every substantiation requirement
C. The time, place, and business purpose of the travel, but not the exact amount spent
D. Original itemized hotel and restaurant receipts corresponding to each day of business travel

75. A sole proprietor pays an unincorporated independent contractor $750 during the year for consulting services. What is the proprietor's Form 1099-NEC reporting obligation?

A. No reporting is required because payments to consultants are always exempt from information reporting
B. The proprietor must file Form 1099-NEC because payments exceed the $600 reporting threshold
C. Reporting is required only if the contractor is paid more than $10,000 during the year
D. The proprietor must file Form 1099-MISC rather than Form 1099-NEC for consulting payments

76. An employer hires a new employee. Within what general timeframe must the employer report the new hire to the appropriate state new hire reporting agency?

A. Within 20 days of the employee's hire date, per the federal minimum reporting standard
B. Within 90 days of the hire date, to align with the end of the first quarter
C. Only if the new employee will earn wages above the Social Security wage base
D. Within 6 months, coinciding with the employer's first Form 941 filing deadline

77. An applicable large employer (ALE) under the ACA fails to offer minimum essential coverage to at least 95% of its full-time employees, and at least one full-time employee receives a premium tax credit through the Marketplace. What is the general consequence?

A. The ALE loses its ability to deduct any employee wages for federal income tax purposes
B. The ALE's full-time employees become personally liable for repaying the premium tax credit received
C. The ALE must retroactively reclassify all full-time employees as independent contractors for the year
D. The ALE becomes liable for an employer shared responsibility payment calculated on a monthly basis

78. An employer provides an employee with employer-paid parking near the workplace and a separate transit pass, both under a qualified transportation fringe benefit arrangement. How are these two benefits treated for the monthly income exclusion limit?

A. The two benefits share a single combined monthly limit that cannot be exceeded in total

B. Each benefit has its own separate monthly exclusion limit set under Internal Revenue Code Section 132(f)

C. Only the transit pass qualifies for exclusion; employer-paid parking is always fully taxable

D. Only employer-paid parking qualifies for exclusion; transit passes are always fully taxable

79. An employer sponsors a dependent care assistance program (DCAP) under a cafeteria plan, allowing employees to set aside pretax wages for eligible dependent care expenses. What is the maximum amount that a married employee filing a joint return may generally exclude from income under this program?

A. $5,000 per year, subject to the earned income limitations of both spouses

B. $2,500 per year, half the limit available to a single taxpayer

C. $10,500 per year, the same limit as a health flexible spending account

D. There is no dollar limit, provided all expenses are properly substantiated

80. The executor of a decedent's estate is preparing the estate's first Form 1041. Which statement about the estate's income tax year is correct?

A. The estate must adopt a calendar year identical to the decedent's final individual return.

B. The estate must adopt the fiscal year already used by its largest beneficiary.

C. The executor may elect a calendar year or any fiscal year ending within 12 months of death.

D. The estate must use a calendar year unless the IRS grants advance written permission.

81. A trust holding stock in an S corporation wants to remain a qualifying shareholder. Which comparison of the two trust types eligible for this ownership is accurate?

A. Both trust types must distribute all income currently and permit only one income beneficiary.

B. A QSST requires one income beneficiary and mandatory current distributions; an ESBT allows multiple beneficiaries taxed separately.
C. An ESBT must have one income beneficiary while a QSST may have unlimited beneficiaries.
D. Neither trust type may hold S corporation stock without a separate corporate-level election.

82. A grantor establishes a trust that will distribute assets to grandchildren only, entirely bypassing the grantor's own children. Which tax most directly applies to this arrangement?

A. The alternative minimum tax imposed on the trust's fiduciary income.
B. The accumulated earnings tax imposed on undistributed corporate profits.
C. The net investment income tax imposed on passive trust earnings.
D. The generation-skipping transfer tax imposed on transfers that skip a generation.

83. A trust instrument gives a beneficiary the right to withdraw a contribution made to the trust for a limited 30-day window each year. What is the primary tax purpose of including this power?

A. It permits the trustee to defer recognition of trust accounting income indefinitely.
B. It reclassifies the trust from complex to simple for the withdrawal year.
C. It converts a future interest gift into a present interest eligible for the annual exclusion.
D. It exempts the contribution from generation-skipping transfer tax reporting.

84. A grantor wants to make annual gifts to a minor child while qualifying for the gift tax annual exclusion, but prefers not to draft Crummey withdrawal language. Which vehicle serves this purpose?

A. A Section 2503(c) trust that must distribute principal to the minor at age 21.
B. A revocable living trust that terminates automatically at the grantor's death.
C. A charitable remainder trust naming the minor as income beneficiary for life.
D. A qualified terminable interest property trust naming the minor as remainderman.

85. Two private foundations are compared: one primarily conducts its own charitable programs, and the other primarily makes grants to other organizations. How does the tax law distinguish them?

A. Grant-making foundations are automatically reclassified as public charities after five years.

B. Only operating foundations are permitted to accept deductible contributions of any kind.

C. A private operating foundation directly runs charitable activities, while a non-operating foundation mainly funds outside grantees.

D. Non-operating foundations are exempt from the excise tax on net investment income.

86. A public charity's executive director receives compensation and perks far exceeding fair market value for services rendered. Which mechanism allows the IRS to penalize this without revoking the charity's exempt status outright?

A. The private foundation self-dealing excise tax imposed under Section 4941.

B. Intermediate sanctions imposing an excess benefit transaction excise tax on the individual involved.

C. The unrelated business income tax reported by the organization on Form 990-T.

D. Mandatory reclassification of the charity as a private foundation for the tax year.

87. A local church has never filed an annual information return with the IRS despite being recognized as tax-exempt. Is this a compliance problem?

A. No, churches are specifically excused from the Form 990 annual filing requirement.

B. Yes, all Section 501(c)(3) organizations must file Form 990 regardless of type.

C. No, but only if the church's gross receipts exceed $250,000 annually.

D. Yes, unless the church has fewer than five active members on its rolls.

88. A private foundation's founder wants to sell personal real estate directly to the foundation at a price below fair market value. Under Section 4941, how is this transaction treated?

A. It is permitted freely because the sale price favors the foundation, not the founder.

B. It is permitted only if approved in advance by the foundation's independent auditor.

C. It is permitted if the foundation reports the bargain element as unrelated business income.

D. It is a prohibited act of self-dealing between the foundation and a disqualified person.

89. Most net operating loss carrybacks were eliminated by recent tax legislation. Which type of loss retained a special carryback option unavailable to most other businesses?

A. Losses generated by a rental real estate professional's real property trades.
B. A farming loss, which retains a two-year net operating loss carryback exception.
C. Losses generated by a private foundation's unrelated business activities.
D. Losses generated by a professional service corporation electing S status.

90. A grain farmer harvests a large crop in December but does not want the sale proceeds taxed in the current year. What technique legitimately defers the income to the following year?

A. Selling the crop under a valid installment sale contract with payment due the next year.
B. Recording the sale in December but simply omitting it from Schedule F entirely.
C. Transferring the crop to a related corporation at cost with no gain recognized.
D. Reclassifying the crop sale as a Section 1231 disposition of business property.

91. A self-employed sole proprietor wants to establish a qualified retirement plan that allows both employee deferrals and larger employer contributions than an IRA-based plan permits. Which plan type fits this description?

A. A payroll deduction IRA offered informally through the business.
B. A SIMPLE IRA funded solely through employee salary reduction.
C. A traditional or Roth IRA established in the owner's own name.
D. A Keogh, or HR-10, plan designed for self-employed individuals.

92. A small business 401(k) plan is found to disproportionately benefit its owners and officers relative to rank-and-file employees. What set of rules is triggered by this imbalance?

A. The excess benefit transaction rules applicable to tax-exempt organizations.
B. The Section 4941 self-dealing rules applicable to private foundations.
C. The top-heavy plan rules, which require minimum contributions for non-key employees.
D. The unrelated business income tax rules applicable to qualified trusts.

93. A taxpayer owns four separate rental properties and struggles to meet the material participation hours for any single property. What election can help satisfy the material participation test?

A. Electing to depreciate all four properties using the same recovery period.
B. Electing out of the passive activity loss rules entirely for all rentals.
C. Electing to file each property on a separate Schedule E page.
D. Electing to group all rental real estate interests as one single activity.

94. A taxpayer rents out a vacation home and also uses it personally throughout the year. Which factor determines whether the deductible rental expenses are limited under Section 280A?

A. Whether the property is located within fifty miles of the taxpayer's main residence.
B. The ratio of the taxpayer's personal-use days to the total rental-use days.
C. Whether the taxpayer materially participates in managing the property full time.
D. Whether the taxpayer is classified as a real estate professional that year.

95. A taxpayer's passive rental loss cannot be deducted in the current year because it exceeds allowable limits. What happens to the disallowed portion of that loss?

A. It is permanently forfeited and cannot be used in any future tax year.
B. It converts automatically into a net operating loss carried back two years.
C. It is suspended and carried forward until the activity is disposed of in a fully taxable transaction.
D. It reduces the taxpayer's basis in the activity but is never separately deductible.

96. An estate distributes cash to its sole beneficiary during the tax year. How does the estate's income distribution deduction generally function on Form 1041?

A. It lets the estate deduct amounts distributed, capped at distributable net income, shifting that income to the beneficiary.
B. It allows the estate to deduct distributions without regard to any income limitation whatsoever.

C. It applies only when the estate has elected complex trust treatment for the year.
D. It is available only after the estate has been open for more than two years.

97. One trust was created by a will and took effect only after the grantor's death, while another trust was created and funded during the grantor's lifetime. How are these two trusts classified?

A. Both are classified as grantor trusts regardless of when they were funded.
B. Both are classified as complex trusts because of their differing funding dates.
C. The first is a testamentary trust, and the second is an inter vivos trust.
D. The first is an inter vivos trust, and the second is a testamentary trust.

98. A taxpayer raises horses on a small acreage, incurring losses every year for a decade while showing no real business planning or record-keeping. How would this activity most likely be treated for tax purposes?

A. As a hobby under the profit-motive test, limiting the deductibility of related losses.
B. As a Schedule F farming business entitled to income averaging on Schedule J.
C. As a Section 1231 trade or business regardless of the taxpayer's intent.
D. As a passive rental activity eligible for the active participation loss allowance.

99. A private foundation wants to voluntarily end its private foundation status and operate going forward as a public charity or distribute its remaining assets. What potential tax consequence must it consider?

A. An automatic waiver of all prior excise taxes the foundation ever paid.
B. A mandatory conversion into a for-profit taxable corporation within one year.
C. Immediate loss of federal tax-exempt status for any successor organization it creates.
D. A termination tax under Section 507 based on the foundation's aggregate tax benefits.

100. A farmer leases cropland to another party under two arrangements: one is a fixed cash rent, and the other is a crop-share arrangement where the landowner participates in farming decisions. How does this distinction typically affect self-employment tax?

A. Neither arrangement can ever generate self-employment tax for the landowner.

B. Material participation under a crop-share lease can subject the landowner's income to self-employment tax.

C. Fixed cash rent always triggers self-employment tax regardless of participation level.

D. Both arrangements are treated identically as passive rental income for tax purposes.

Answer Key and Explanations — Practice Exam 16, Part 2: Businesses

1. A — The majority-interest taxable year rule requires a partnership to adopt the tax year used by partners owning more than 50% of profits and capital, tested annually. Here X and Y together hold 80% and both use the calendar year, so that year controls automatically, regardless of Z's fiscal year, without needing the principal partners or least-aggregate-deferral tests.

2. D — Section 706(d)'s varying interests rule prevents shifting income to disguise its true economic owner when ownership changes mid-year. The partnership must divide the year into segments reflecting each partner's actual percentage during each period, using either an interim closing of the books or a daily proration method, rather than letting partners freely allocate the entire year's result.

3. C — Section 751 treats unrealized receivables and substantially appreciated inventory as hot assets. When a partner sells her interest, the portion of gain attributable to these items is recharacterized from capital gain into ordinary income, preventing partners from converting what would otherwise be ordinary income into more favorably taxed capital gain simply by selling the partnership interest instead.

4. B — In a nonliquidating distribution, the distributed property generally carries over the partnership's inside basis, capped at the distributee partner's outside basis in the partnership interest. Without a Section 754 election, the bases of the partnership's remaining assets are unaffected by the distribution, even though the distribution may permanently shift basis between the partner and the partnership.

5. D — When a partner contributes a capital asset or Section 1231 property to a partnership, the partner's holding period for the contributed asset tacks onto the holding period of the partnership interest received. Because the land had already been held four years as an investment, that period carries forward, allowing the partnership interest to qualify for long-term treatment immediately.

6. B — Syndication costs, such as expenses for marketing and selling partnership interests, are capitalized but may never be deducted or amortized, in contrast to organizational costs, which allow a limited current deduction with the remainder amortized over 180 months. This distinction reflects that syndication costs relate to raising capital rather than forming or operating the business itself.

7. A — A partnership interest that is truly worthless, with no assets, no prospects, and no further capital obligations, may generate a deductible loss in the year worthlessness is established, even absent a formal abandonment or identifiable transaction. The character of the loss depends on facts such as whether liabilities were allocated to the partner at the time the interest ended.

8. C — Recourse liabilities are allocated to the partner or partners who bear the economic risk of loss if the partnership could not pay the debt, often the general partner. Nonrecourse liabilities, lacking personal liability, are instead allocated using rules tied to profit-sharing ratios and minimum gain chargeback principles, since no single partner is personally exposed to the debt.

9. D — The at-risk rules under Section 465 limit deductible losses to the amount a partner actually has economically at risk, which can be lower than outside basis when nonrecourse financing lacks personal exposure. Here, only $15,000 of the $25,000 loss is currently deductible; the remaining $10,000 is suspended and carried forward until her at-risk amount rises.

10. B — In a tiered partnership structure, the lower-tier partnership's income, deductions, and credits retain their character as they pass through to the upper-tier partnership, which is a partner. The upper-tier partnership then passes those same items through to its own partners, so ultimate individual partners report items originating at the lowest tier with character preserved throughout.

11. A — Under the default assets-over rule for partnership mergers, the resulting partnership continues whichever merging partnership's partners own more than 50% of capital and profits interests in the new entity. The other partnership is deemed to terminate, contributing its assets and liabilities to the survivor in exchange for interests, then distributing those interests to its own partners.

12. D — A valid Section 761(a) election out of subchapter K is limited to qualifying investing, operating, or securities-dealing ventures where income can be readily computed without partnership accounting. Once elected, each co-owner reports his or her proportionate share of income, deductions, and credits directly on an individual return, and the venture avoids partnership-level filing and entity-level rules entirely.

13. C — Spouses who wholly own and jointly operate an unincorporated business, including one held as community property, may elect qualified joint venture treatment. Each spouse then reports his or her share of income, deductions, gain, and loss on a separate Schedule C, avoiding the partnership return filing requirement while still dividing self-employment tax based on each spouse's proportionate share.

14. B — Under the BBA regime, the partnership representative has sole authority to act for the partnership and bind all partners in dealings with the IRS, including agreeing to proposed adjustments or electing an alternative to entity-level payment. Partners generally have no separate right to participate, and the representative need not even be a partner of the partnership.

15. A — Unlike a profits interest, which generally is not taxed at grant, a capital interest received for services gives the recipient an immediate stake in existing partnership capital. Its fair market value is taxed as ordinary compensation income to the partner in the year received, and the partnership generally deducts that same amount as a business expense in the same period.

16. C — A partnership's deduction timing for a guaranteed payment follows its own accounting method, so an accrual-basis partnership deducts it when accrued. The recipient partner includes the payment in income for the partner's tax year within which the partnership's tax year giving rise to the payment ends, regardless of the partner's own accounting method or when cash is actually received.

17. A — When neither the majority-interest taxable year rule nor the principal partners test, which looks at partners owning a 5% or greater interest, resolves the required year, the partnership falls back to the least-aggregate-deferral method. This calculation tests each partner's tax year end and selects whichever produces the smallest total deferral of income across all the partners combined.

18. D — Inventory is substantially appreciated when its aggregate fair market value exceeds 120% of its aggregate adjusted basis to the partnership. When such inventory exists, Section 751 requires the selling partner to treat the portion of gain attributable to it as ordinary income, preventing conversion of what is essentially ordinary income potential into capital gain through the sale.

19. C — The one-class-of-stock rule looks only at rights to distributions and liquidation proceeds, not voting power. Corporations may issue voting and nonvoting common stock without violating S status, since both classes still share identical economic rights. A second class arises only when shareholders' rights to profits or liquidation proceeds actually differ.

20. B — Debt basis requires an actual economic outlay by the shareholder, meaning funds loaned directly from the shareholder to the corporation. A guarantee is merely a promise to pay if the corporation defaults; unless the shareholder actually makes payments on the guaranteed debt, no bona fide loan exists and no debt basis is created.

21. C — A redemption is substantially disproportionate when the shareholder's post-redemption voting stock percentage falls below 80% of the pre-redemption percentage, and the shareholder also owns less than 50% of total voting power immediately afterward. Meeting both tests together allows sale or exchange treatment; otherwise the distribution is generally taxed as an ordinary dividend.

22. B — A Type B reorganization requires the acquiring corporation to obtain control of the target solely by exchanging its own voting stock for the target's stock, with no boot permitted. The target survives as a subsidiary rather than merging into the acquirer. This distinguishes it from Type A mergers and Type C asset acquisitions.

23. A — A brother-sister controlled group exists when five or fewer common owners hold at least 80% of each corporation and more than 50% identically across both. Controlled group status matters because related corporations generally must divide a single set of tax brackets and other statutory dollar limits, preventing abuse through multiple entities.

24. D — Shareholder-employees owning more than 2% of an S corporation are treated like partners for fringe benefit purposes rather than like regular employees. Employer-paid health insurance and similar benefits are generally taxable, added to the shareholder's W-2 wages, though the shareholder may then claim the self-employed health insurance deduction on their personal return.

25. C — A corporation's charitable contribution deduction is generally capped at 10% of taxable income, computed before the contribution deduction and certain other items. Amounts exceeding the limit are not lost; they may generally be carried forward and deducted in future years, subject to the same 10% ceiling and a limited carryforward period.

26. D — The dividends-received deduction lets a corporate shareholder deduct a percentage of dividends received from another taxable corporation, easing the burden of taxing the same earnings repeatedly as they pass through multiple corporate layers. The deductible percentage generally increases with the recipient's ownership stake, ranging from smaller ownership up through majority or affiliated ownership.

27. A — The Tax Cuts and Jobs Act repealed the old corporate AMT for most corporations starting after 2017. Later legislation created a new Corporate Alternative Minimum Tax, but it applies narrowly to large "applicable corporations" whose average adjusted financial statement income exceeds specified thresholds, not to typical small or mid-sized C corporations.

28. B — For losses arising in tax years beginning after 2017, the NOL deduction is limited to 80% of taxable income in the carryforward year, computed without regard to the NOL deduction itself. Any unused portion continues to carry forward indefinitely, unlike the two-year carryback and full offset allowed under older, pre-2018 rules.

29. B — Shareholder-employees who perform meaningful services must be paid reasonable compensation before taking distributions, because wages are subject to payroll taxes while distributions generally are not. When salary is artificially low relative to services rendered and comparable pay, the IRS may reclassify part of the distributions as wages and assess employment taxes accordingly.

30. C — Both professional corporations and professional limited liability companies limit an owner's exposure to the business's general debts and to malpractice committed by other owners or employees. Neither structure, however, shields the professional from personal liability for their own malpractice; the entity choice mainly affects tax treatment, formalities, and governance rather than personal liability.

31. A — A series LLC is a single legal entity that internally segregates assets, liabilities, and members into distinct series, each maintaining its own records under the governing statute. When properly maintained, each series generally has its own liability shield, so creditors of one series generally cannot reach assets held within a different series.

32. D — A Type C reorganization involves the acquiring corporation obtaining substantially all of the target's assets primarily in exchange for the acquirer's voting stock. The target then liquidates, distributing the acquirer's stock and any remaining assets to its own shareholders. This differs from a Type A merger, since the target's separate corporate existence ends through liquidation rather than merger.

33. C — A redemption that completely terminates a shareholder's entire direct and attributed interest in the corporation qualifies for sale or exchange treatment, generating capital gain or loss rather than ordinary dividend income. Because Sandra retains no stock, no officer or director role, and no family attribution applies, the complete-termination exception is satisfied.

34. D — The one-class-of-stock requirement focuses on rights to distributions and liquidation proceeds, not voting power. Governing provisions that give different shareholders disproportionate distribution rights per share create a second class of stock in substance, which is impermissible for an S corporation and can result in an inadvertent termination of the S election.

35. A — A parent-subsidiary controlled group exists when one corporation, or a chain of corporations, owns at least 80% of the total voting power or value of another corporation's stock. Here, Parent Corp's 90% ownership of Subsidiary Corp exceeds the 80% threshold, so the two corporations form a parent-subsidiary controlled group for tax purposes.

36. B — Section 183 creates a rebuttable presumption of profit motive when an activity shows a profit in at least three of the five most recently completed tax years (two of seven for activities involving breeding, training, showing, or racing horses). Meeting this threshold shifts the burden to the IRS to prove the activity is not engaged in for profit.

37. A — The Tax Cuts and Jobs Act eliminated the deduction for entertainment, amusement, and recreation expenses entirely, even when directly related to or associated with an active trade or business. This differs from the 50% limitation on business meals, which generally remains deductible when the taxpayer or an employee is present and the meal is not lavish.

38. D — Employee achievement awards for length of service or safety achievement are excludable from income and deductible by the employer, up to $400 per employee ($1,600 for a qualified plan award), only when given as tangible personal property rather than cash, cash equivalents, gift cards, vacations, meals, or securities. Length-of-service awards generally cannot be given within the employee's first five years.

39. C — Amounts paid or incurred to influence legislation, participate in political campaigns, or attempt to influence the general public on legislative matters (grassroots lobbying) are nondeductible under Section 162(e), regardless of how directly the legislation relates to the taxpayer's trade or business. A narrow exception exists for certain local government lobbying and in-house expenditures under a de minimis threshold.

40. B — Under Section 162(f), no deduction is allowed for any amount paid or incurred to a government, or governmental entity, for the violation of any law, including fines and penalties, regardless of whether the violation was intentional. A limited exception applies to amounts identified as restitution or paid to come into compliance with a law.

41. A — Section 264(a)(1) disallows a deduction for premiums paid on any life insurance policy covering the life of an officer or employee, or any person financially interested in the business, when the taxpayer is directly or indirectly a beneficiary under the policy. Because the corporation itself is named beneficiary here, the premiums are nondeductible, though the proceeds are generally received tax-free.

42. B — Section 274(a)(3) disallows any deduction for amounts paid for membership in a club organized for business, pleasure, recreation, or other social purposes, such as country clubs, golf clubs, and athletic clubs, regardless of any business use. Specific business expenses incurred at the club, such as a client meal, may still be separately deductible subject to the usual 50% limitation.

43. C — For tax years 2018 through 2025, the TCJA limits personal casualty and theft loss deductions to losses attributable to a federally declared disaster. Although business (and income-producing) property casualty losses retain some differences from personal-use property rules, current guidance likewise requires a federally declared disaster for a deductible business casualty loss when the loss is not fully offset by insurance.

44. D — In a Section 1031 like-kind exchange, any cash or other non-like-kind property received, known as boot, is not eligible for deferral. Gain is recognized to the extent of the lesser of the boot received or the realized gain on the exchange, even though the exchange of the real property itself otherwise qualifies for nonrecognition treatment.

45. C — Under the all-events test, an accrual-method taxpayer may deduct a liability only when all events have occurred that establish the fact of the liability, the amount can be determined with reasonable accuracy, and economic performance has occurred with respect to that liability. All three requirements must be satisfied; actual cash payment is not itself required for the deduction.

46. D — For services provided to a taxpayer by another party, economic performance occurs as the services are actually performed, not when the liability is merely accrued, a contract is signed, or payment is made. A limited recurring-item exception exists, but the general rule ties the deduction to actual performance of the services.

47. A — When a C corporation using the LIFO inventory method converts to S corporation status, it must include a LIFO recapture amount in its final year as a C corporation, equal to the excess of the inventory's value under FIFO over its value under LIFO. The resulting tax may be paid in four equal annual installments.

48. B — A change in inventory valuation method is a change in accounting method, and a taxpayer generally must obtain the consent of the IRS before adopting it, typically by filing Form 3115, Application for Change in Accounting Method. A taxpayer cannot simply switch inventory methods on a future return without this advance consent.

49. C — Small businesses meeting the gross receipts test, average annual gross receipts of $25 million or less (indexed for inflation) for the three prior tax years, are exempt from the UNICAP rules under Section 263A, regardless of industry. Businesses exceeding this threshold generally must capitalize direct and indirect costs allocable to inventory.

50. A — Dues paid to professional organizations, such as a bar association or a professional licensing body, are deductible as ordinary and necessary business expenses under Section 162 when required or helpful for the taxpayer's trade or business. These professional dues are distinct from nondeductible club dues, which cover organizations organized mainly for pleasure, recreation, or social purposes.

51. D — Section 179 carries an annual dollar cap along with a separate investment ceiling. Once qualifying property placed in service during the year exceeds that investment threshold, the maximum allowable deduction is reduced dollar-for-dollar by the excess, phasing the benefit out entirely once purchases climb high enough above the threshold amount for that tax year.

52. B — Qualified improvement property covers interior improvements to nonresidential buildings, excluding enlargements, elevators, escalators, and structural framework changes. Legislation corrected an earlier drafting error, assigning QIP a 15-year recovery period rather than 39 years. Because the recovery period is under 20 years, QIP also qualifies for bonus depreciation when properly elected by the taxpayer.

53. A — Section 197 intangibles, including purchased goodwill and going-concern value acquired in a trade or business, are amortized ratably using the straight-line method over a fixed 15-year period beginning in the month of acquisition. This fixed recovery period applies regardless of the intangible's actual economic useful life or any book accounting treatment used.

54. D — Depreciation recapture under Section 1245 is never eligible for installment sale deferral. Regardless of payment terms, all recapture income must be reported as ordinary income in the year of sale, with only the remaining gain in excess of recapture eligible for spreading across future installment payments received in subsequent years.

55. C — The Disabled Access Credit, claimed on Form 8826, is available to eligible small businesses that incur expenditures to comply with accessibility requirements, covering costs such as ramps, accessible restrooms, and related modifications. Eligibility generally requires the business to meet prior-year gross receipts and employee count thresholds established under the statute.

56. B — Section 45S provides an employer credit for wages paid to qualifying employees during family and medical leave, provided the employer maintains a written policy offering a minimum leave period and a minimum percentage of normal wages. The credit percentage increases as the wage-replacement rate offered under the policy rises above the statutory floor.

57. D — The low-income housing credit encourages private investment in affordable rental housing by allocating credits to qualified projects through state housing agencies, based on the property's qualified basis and the applicable percentage. Investors generally claim the credit annually in equal installments over a multi-year credit period rather than as a single lump-sum benefit.

58. C — Section 45R rewards qualifying small employers, generally those with fewer than 25 full-time equivalent employees and average wages under the statutory limit, for purchasing employee health coverage through a qualifying marketplace exchange. The credit percentage phases out gradually as employee count and average wages rise toward the statutory ceiling amounts.

59. B — The differential wage payment credit allows eligible small employers to claim a percentage of compensation paid to employees while they serve on active military duty, covering the difference between the employee's regular civilian wages and reduced military pay. This credit specifically targets continued wage support during qualified uniformed service periods.

60. A — Section 179D provides a deduction for energy efficient commercial building property, including lighting, HVAC, and building envelope systems, when the installation achieves energy and power cost reductions meeting the statutory percentage threshold compared to a referenced baseline standard. The deduction amount scales with the certified level of energy savings achieved.

61. D — The QBI aggregation election permits a taxpayer meeting specified ownership, control, and operational-interdependence requirements to combine multiple qualifying trades or businesses when computing the QBI deduction. Aggregating can smooth out wage and UBIA limitations across the businesses, since the combined wages and unadjusted basis are measured together rather than separately for each activity.

62. A — REIT dividends and qualified publicly traded partnership income receive a 20% QBI deduction without being subject to the wage and UBIA limitation that applies to other qualified business income once taxable income exceeds the upper threshold for higher earners. This favorable treatment applies regardless of the taxpayer's overall income level.

63. B — When a taxpayer has multiple general business credit components in the same year, Form 3800 establishes a statutory ordering sequence for applying carryforwards, current-year components, and carrybacks against tax liability. Following this prescribed order ensures credits with shorter remaining carryforward periods are utilized before those with longer remaining periods available.

64. C — The luxury automobile first-year depreciation dollar caps under Section 280F are adjusted annually for inflation and published by the IRS for each placed-in-service year. Because these figures change from year to year, and bonus depreciation adds a separate first-year amount, practitioners must confirm the specific figures applicable to the vehicle's actual placed-in-service year.

65. C — Section 280F's passenger automobile depreciation caps apply specifically to vehicles rated under 6,000 pounds gross vehicle weight. Trucks and SUVs exceeding that weight threshold, like the 6,800-pound pickup, fall outside the passenger automobile definition and are therefore exempt from the luxury auto dollar caps, though other limitations may still apply here.

66. D — Employers must withhold an extra 0.9% Additional Medicare Tax once an employee's wages from that employer exceed $200,000 in a calendar year, regardless of the employee's filing status or other income sources. Unlike the standard 1.45% Medicare tax, the Additional Medicare Tax has no corresponding employer match, so only the employee's share is withheld and remitted to the IRS.

67. B — When a payee fails to furnish a valid taxpayer identification number, the payer generally must begin backup withholding at a flat 24% rate on reportable payments, such as nonemployee compensation. Backup withholding also applies if the IRS notifies the payer the TIN furnished is incorrect. Amounts withheld are remitted to the IRS as a prepayment of the payee's tax liability.

68. A — Form 941 is filed quarterly by most employers to report wages paid, tips reported, and federal income tax withheld, along with both the employer's and employees' shares of Social Security and Medicare tax. It reconciles payroll tax liability against deposits already made during the quarter. Federal unemployment tax is reported separately on Form 940, filed annually.

69. D — An employer's deposit schedule for a calendar year is based on total employment tax liability reported during a four-quarter lookback period ending the prior June 30. Liability of $50,000 or less requires monthly deposits; liability above that threshold requires semiweekly deposits. New employers with no lookback history generally default to a monthly schedule until sufficient history accrues.

70. A — The IRS imposes a tiered penalty on late or insufficient federal tax deposits: 2% for deposits 1-5 days late, 5% for 6-15 days late, and 10% for deposits made 16 or more days late. A 15% penalty applies if the amount remains unpaid more than 10 days after the IRS issues a delinquency notice demanding immediate payment.

71. B — A calendar-year S corporation's Form 1120-S is due March 15, the same due date as a partnership return. Filing Form 7004 grants an automatic 6-month extension, moving the deadline to September 15. Missing the due date without a valid extension can trigger a per-shareholder, per-month late-filing penalty in addition to any tax owed by shareholders individually.

72. C — Unlike partnerships and S corporations, which file by March 15, a calendar-year C corporation's Form 1120 is due April 15, the fifteenth day of the fourth month following the close of its tax year. A timely filed Form 7004 provides an automatic 6-month extension, pushing the deadline to October 15 for a calendar-year filer.

73. D — An accountable plan requires that reimbursed expenses have a business connection, that the employee substantiate the expenses (amount, time, place, and purpose) within a reasonable period, and that any excess reimbursement over substantiated expenses be returned to the employer within a reasonable time. Meeting all three conditions keeps reimbursements out of taxable wages and off Form W-2.

74. C — Under the high-low substantiation method, the employer's reimbursement uses IRS-published per diem rates in place of actual receipts for lodging, meals, and incidentals. The employee still must substantiate the time, place, and business purpose of each trip, but does not need to document the exact dollar amount spent, since the per diem rate itself satisfies the amount element.

75. B — Payers must file Form 1099-NEC to report nonemployee compensation of $600 or more paid during the year to an unincorporated independent contractor for services performed in the course of a trade or business. Since the $750 payment exceeds this threshold, the proprietor must issue Form 1099-NEC to the contractor and file a copy with the IRS.

76. A — Federal law requires employers to report newly hired employees to the state new hire reporting agency, generally within 20 days of the hire date, though some states set a shorter deadline. This reporting supports child support enforcement efforts and helps states detect improper unemployment or workers' compensation benefit claims. The requirement applies regardless of the employee's wage level or hours.

77. D — Under the ACA employer mandate, an applicable large employer that fails to offer minimum essential coverage to at least 95% of its full-time employees, where at least one employee receives a premium tax credit, owes an employer shared responsibility payment. The payment is calculated monthly, based on full-time headcount minus a statutory exclusion, not as a flat annual fine.

78. B — Qualified transportation fringe benefits, including employer-provided parking and transit passes, each carry their own separate monthly exclusion limit under Section 132(f), which is adjusted annually for inflation. Amounts provided in excess of the applicable monthly limit for either benefit are included in the employee's taxable wages. The two categories are not combined into a single shared monthly cap.

79. A — Under a dependent care assistance program, an employee may generally exclude up to $5,000 per year from income for eligible dependent care expenses, whether married filing jointly or single; married individuals filing separately are limited to $2,500 each. The exclusion cannot exceed the earned income of either spouse, and amounts above the limit are taxable wages.

80. C — Unlike individuals, an estate is not forced onto a calendar year. The executor may choose either a calendar year or any fiscal year, provided the first period ends no more than twelve months after the date of death. This choice affects when beneficiaries report distributed income, since it establishes the estate's own separate reporting period going forward.

81. B — A Qualified Subchapter S Trust must have a single income beneficiary and distribute all trust accounting income currently, with that beneficiary treated as the deemed owner for tax purposes. An Electing Small Business Trust permits multiple beneficiaries, including contingent ones, and computes tax on S corporation income separately at the trust level using compressed brackets.

82. D — When a trust arrangement transfers wealth to grandchildren while bypassing the grantor's children, it constitutes a generation-skipping transfer. This separate transfer tax exists alongside gift and estate tax specifically to prevent families from avoiding an entire layer of transfer taxation by skipping over one generation of intended beneficiaries in the transfer structure.

83. C — A temporary withdrawal right, commonly called a Crummey power, gives the beneficiary a real, present ability to demand the contributed funds for a limited period. That present access is what converts what would otherwise be a future interest gift into a present interest gift, allowing the contribution to qualify for the annual gift tax exclusion.

84. A — A Section 2503(c) minor's trust satisfies the present-interest requirement for the annual exclusion through statutory design rather than a withdrawal power. The trust must permit principal and income to be spent for the minor's benefit, and any remaining assets must be distributed to the minor at age twenty-one, avoiding the need for Crummey language.

85. C — A private operating foundation devotes most of its resources directly to conducting its own charitable, educational, or scientific programs, rather than simply funding others. A non-operating, or grant-making, foundation instead distributes the bulk of its resources as grants to outside charitable organizations, which is the more common private foundation structure encountered in practice.

86. B — Intermediate sanctions allow the IRS to impose an excise tax directly on the individual who received an excessive economic benefit from a public charity, and potentially on organization managers who approved it, without necessarily revoking the charity's exempt status. This targeted penalty addresses private inurement concerns while preserving the organization's ability to continue operating.

87. A — Churches, their integrated auxiliaries, and conventions or associations of churches are specifically excepted from the requirement to file an annual Form 990 information return, regardless of the size of their gross receipts. This exception does not affect their underlying tax-exempt status; it only removes the annual information-reporting obligation that applies to most other exempt organizations.

88. D — Section 4941 broadly prohibits acts of self-dealing between a private foundation and its disqualified persons, which includes substantial contributors, foundation managers, and their family members. A sale or exchange of property between the foundation and a disqualified person is prohibited outright, even at a bargain price favorable to the foundation, triggering excise taxes on the participants.

89. B — While the general two-year net operating loss carryback was repealed for most taxpayers, Congress preserved a special two-year carryback for losses attributable to farming businesses. This narrow exception recognizes the unique income volatility farmers face from weather, commodity prices, and crop cycles, letting farm losses offset income from the two immediately preceding tax years.

90. A — A farmer can legitimately defer recognizing crop sale proceeds by structuring the transaction as a valid installment sale, with payment contractually due and received in the following tax year. Because the farmer has a genuine right to receive payment later rather than immediately, the income is properly reported in the year payment is actually received.

91. D — A Keogh, or HR-10, plan is a qualified retirement plan designed for self-employed individuals and unincorporated businesses, permitting both the owner's contributions as an employer and, depending on plan design, higher overall funding levels than IRA-based arrangements like SEP or SIMPLE plans allow. It requires more administrative upkeep but offers greater contribution flexibility for self-employed savers.

92. C — Top-heavy plan rules apply when the account balances of key employees, generally owners and officers, exceed sixty percent of total plan assets. Once a plan is deemed top-heavy, the employer must generally provide minimum contributions or benefits to non-key employees and may need to accelerate vesting schedules to avoid disproportionately favoring the plan's key participants.

93. D — Taxpayers who own multiple rental real estate interests may elect to treat all such interests as a single combined activity for purposes of testing material participation. Grouping the properties together makes it far easier to accumulate the necessary participation hours across the combined activity, rather than trying to separately satisfy the material participation test property by property.

94. B — Section 280A limits rental expense deductions when a dwelling unit is used personally by the taxpayer for more than the greater of fourteen days or ten percent of the days it is rented at fair value. The relative proportion of personal-use days compared to rental-use days determines whether the property is treated primarily as a residence rather than rental property.

95. C — Passive losses disallowed in the current year because they exceed passive income and any applicable special allowance do not disappear. They remain suspended and carry forward indefinitely to future tax years, where they can offset future passive income, until the taxpayer disposes of the entire activity in a fully taxable transaction to an unrelated party.

96. A — An estate's income distribution deduction allows it to deduct amounts actually distributed or required to be distributed to beneficiaries during the year, but that deduction cannot exceed the estate's distributable net income. This mechanism shifts the taxed income from the estate itself to the beneficiaries who received the distributions, preventing the same income from being taxed twice.

97. C — A testamentary trust is created under the terms of a decedent's will and only comes into existence and receives funding after the grantor's death, typically following probate. An inter vivos trust, by contrast, is established and funded by the grantor during their own lifetime, and can be either revocable or irrevocable depending on how it was originally drafted.

98. A — An activity conducted without a genuine, demonstrable profit motive, evidenced here by consistent losses and an absence of businesslike record-keeping over many years, is generally treated as a hobby rather than a trade or business. Under the hobby loss rules, expenses attributable to hobby activities cannot be used to generate or increase a deductible loss against other income.

99. D — When a private foundation voluntarily terminates its private foundation status, Section 507 can impose a termination tax equal to the lesser of the foundation's net assets or the aggregate tax benefit the foundation and its substantial contributors received from the foundation's tax-exempt history. Certain transfers to public charities or twelve-month terminations can help avoid this tax.

100. B — Cash rent from farmland is generally treated as passive rental income not subject to self-employment tax, since the landowner typically has no material involvement in production decisions. Under a crop-share lease where the landowner materially participates in management or production decisions, however, the resulting income can be classified as self-employment income subject to self-employment tax.