PRACTICE EXAM 17: 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 partner contributes property with a fair market value exceeding its adjusted tax basis to a partnership in exchange for a partnership interest. Under IRC Section 704(c), what is the primary purpose of the special allocation rules that apply to this contributed property?

A. To allocate the built-in gain or loss existing at contribution to the contributing partner, not to other partners
B. To require the partnership to recognize the entire built-in gain immediately upon the property's contribution
C. To let the contributing partner permanently avoid reporting any built-in gain even after the property is sold
D. To convert the built-in gain into tax-exempt income once the property becomes partnership property

2. A partnership uses the traditional method under Section 704(c) to allocate items from contributed built-in gain property. The property's tax depreciation is smaller than its book depreciation because tax basis is lower than book value. What limitation does the 'ceiling rule' impose in this situation?

A. It requires the noncontributing partners to receive a cash payment equal to the depreciation shortfall each year

B. It forces the contributing partner to contribute additional cash to make up the depreciation difference

C. It eliminates Section 704(c) allocations entirely once the ceiling rule is triggered for any item

D. It caps tax items allocated to noncontributing partners at the total tax amount actually available at the partnership level

3. A partnership using the traditional method for Section 704(c) allocations finds that the ceiling rule prevents noncontributing partners from receiving their full book share of tax depreciation on contributed property. The partnership adopts the curative allocation method instead. How does this method address the distortion?

A. It amends prior-year returns to retroactively reallocate the original built-in gain to a different partner

B. It reallocates other partnership tax items, such as income or gain, to offset the shortfall caused by the ceiling rule

C. It requires the partnership to sell the contributed property immediately to eliminate the built-in gain

D. It suspends all future depreciation deductions until the contributed property is fully depreciated for book purposes

4. A partnership adopts the remedial allocation method under Section 704(c) to address a ceiling rule distortion involving contributed built-in gain property. How does the remedial method differ from the curative method in eliminating the distortion?

A. It requires the contributing partner to forfeit their partnership interest to eliminate the distortion permanently

B. It reallocates existing income items among the partners in the same manner as the curative method

C. It creates offsetting notional tax items, giving one partner additional deduction and the other matching income

D. It converts the entire built-in gain into a permanently tax-exempt item for all partners involved

5. A partnership agreement contains a deficit restoration obligation (DRO) requiring a partner to restore any deficit balance in her capital account upon liquidation of her partnership interest. What effect does this DRO generally have on the partner's allocations under the substantial economic effect test?

A. It supports finding economic effect for loss allocations up to the amount the partner is obligated to restore

B. It automatically disqualifies the partnership's allocations from having any economic effect whatsoever

C. It has no bearing on economic effect and only affects the partner's basis for at-risk purposes

D. It permits the partner to receive allocations without ever maintaining a capital account at all

6. A limited partner invests in a partnership that owns commercial real property financed by a nonrecourse loan from an unrelated commercial lender, secured only by the real property itself, with no partner personally liable. Under Section 465, why might this debt still increase the partner's at-risk amount despite being nonrecourse?

A. Nonrecourse real estate debt is always excluded from at-risk regardless of the lender or collateral involved

B. It may qualify as qualified nonrecourse financing, a real property exception that increases at-risk despite the lack of personal liability

C. The partner must personally guarantee the loan before any nonrecourse amount can affect the at-risk calculation

D. Nonrecourse financing only affects outside basis under Section 752 and can never affect the at-risk amount

7. An existing general partnership wants to convert into a C corporation. The partnership contributes all of its assets and liabilities to a newly formed corporation solely in exchange for all of the corporation's stock, then liquidates and distributes that stock to the partners. What governs whether this incorporation is tax-free?

A. The transaction is automatically taxable because partnerships cannot convert into corporations under any circumstances

B. The transaction is tax-free only if every partner individually owned the contributed assets for at least five years

C. The transaction requires a private letter ruling from the IRS before it can ever be tax-free

D. The transaction can qualify as a tax-free incorporation under Section 351 if the partners hold at least 80 percent control of the corporation immediately afterward

8. A partner in a calendar-year partnership dies on August 15. The partnership continues operating with its remaining partners after her death. For federal income tax purposes, what happens to the partnership's tax year with respect to the deceased partner?

A. The entire partnership must dissolve and file a final return as of the date of death

B. The partnership's tax year is suspended entirely until a new partner is formally admitted to replace her

C. The partnership's tax year closes with respect to the deceased partner, whose distributive share is prorated through the date of death

D. The remaining partners must retroactively amend all prior returns filed before the date of the partner's death

9. A partner dies while holding a partnership interest, and the partnership has not made a Section 754 election. Her estate succeeds to the interest. How does the estate's basis in the interest compare to the partnership's inside basis in its underlying assets immediately after her death?

A. Both bases automatically become identical because death always triggers a mandatory basis adjustment regardless of any election

B. Neither basis changes at all, since death has no basis consequences for partnership interests under current law

C. The inside basis of partnership assets is stepped up automatically, while the estate's outside basis remains unchanged

D. The estate's outside basis steps up to fair market value under Section 1014, but inside basis remains unchanged without a 754 election

10. A partner contributes property to a partnership when the property's adjusted basis exceeds its fair market value, creating a built-in loss. Under Section 704(c)(1)(C), when the partnership later sells the property at a loss, how must that built-in loss be allocated among the partners?

A. The built-in loss must be allocated equally among all partners regardless of who originally contributed the property

B. The built-in loss may be taken into account only by the partner who originally contributed the property

C. The built-in loss is permanently disallowed to every partner, including the one who contributed the property

D. The built-in loss is automatically converted into a nondeductible capital expenditure for the entire partnership

11. A partnership interest is transferred, and the partnership has a substantial built-in loss immediately after the transfer, exceeding $250,000 measured under Section 743. The partnership has not made a Section 754 election. What is the effect of this threshold under current law?

A. The partnership must make a mandatory basis adjustment under Section 743(b) even without a Section 754 election in effect
B. No basis adjustment of any kind is ever permitted unless a Section 754 election is separately and affirmatively made
C. The transferee partner automatically forfeits any basis in the transferred partnership interest once the threshold is exceeded
D. The $250,000 threshold only applies to distributions of property and never applies to transfers of partnership interests

12. A partnership admits a new partner who contributes cash for a partnership interest. Under the partnership agreement's capital account maintenance provisions, the partnership revalues (books up) its existing property to fair market value immediately before the admission. What does this revaluation create?

A. A permanent cancellation of all future depreciation deductions on the revalued property for every partner in the partnership
B. An immediate taxable gain recognized by the partnership on all of its previously held appreciated property
C. A new book-tax disparity on the revalued property, allocated among the existing partners under reverse Section 704(c) principles
D. A mandatory liquidation of the partnership because revaluation is only permitted immediately before a complete winding up

13. A sole proprietor operates an unincorporated consulting business and pays premiums for a health insurance policy covering herself and her family. The business generates $60,000 of net Schedule C profit for the year. How does the proprietor generally treat these health insurance premiums for federal income tax purposes?

A. The premiums are deductible only as a miscellaneous itemized deduction subject to the two-percent adjusted gross income floor

B. The premiums are generally deductible above the line, limited to the proprietor's net self-employment earnings from that business

C. The premiums are never deductible unless the proprietor also operates the business as an S corporation instead

D. The premiums must be capitalized and recovered ratably over the fifteen-year life of the insurance contract

14. A partnership agreement provides that Partner Grace receives a fixed $20,000 payment each year for the use of capital she contributed, determined without regard to partnership income. This payment is distinct from any payment for services rendered. How is this capital-based guaranteed payment generally treated for self-employment tax purposes?

A. It is included in Grace's net earnings from self-employment in the same manner as a guaranteed payment for services

B. It is exempt from federal income tax entirely because it represents a return of her original capital contribution

C. It must be reported as wages subject to federal income tax withholding by the partnership itself

D. It is treated similarly to interest income and is generally excluded from net earnings from self-employment

15. A partnership agreement lacks any deficit restoration obligation, but includes a qualified income offset provision instead. A partner unexpectedly receives an allocation that creates a deficit in her capital account due to certain specified capital account adjustments. What must the qualified income offset provision require?

A. The partner must be allocated income and gain as quickly as possible to eliminate the unexpected deficit

B. The partnership must immediately liquidate to prevent the deficit from ever appearing on its books

C. The partner must personally contribute cash equal to the deficit before any future allocations may occur

D. The deficit must simply be carried forward indefinitely with no corrective allocation ever required by the agreement

16. A partner's outside basis in her partnership interest must be adjusted throughout the year to reflect various partnership transactions. Under the general ordering rules for outside basis, in what sequence are increases and decreases generally applied for a given tax year?

A. Basis is decreased by distributions and losses first, then increased afterward by that year's income items and contributions

B. Basis is adjusted only once per year using a single net figure combining every item without any set order

C. Basis is increased first by income items and contributions, then decreased by distributions, then decreased by losses

D. Basis is permanently fixed at the amount of the partner's original contribution and is never adjusted afterward

17. A partner contributes property with a built-in gain to a partnership. Within seven years of the contribution, the partnership distributes that same property to a different partner. Under Section 704(c)(1)(B), what tax consequence results from this distribution?

A. No gain or loss is ever recognized because partnership distributions of property are always entirely nonrecognition events

B. The distributee partner recognizes the entire built-in gain personally, even though she never contributed the property

C. The contributing partner must recognize the precontribution built-in gain as though the property had been sold to the distributee

D. The partnership itself must recognize the built-in gain at the entity level and pay tax on the distribution

18. A partnership makes payments to a retiring general partner in a service partnership over several years after her withdrawal, in liquidation of her entire interest. Some payments are for her share of partnership property, and others are unrelated to property. How does Section 736 generally classify these payments?

A. All liquidating payments to a retiring partner are automatically classified as capital gain regardless of what they represent

B. All liquidating payments to a retiring partner are automatically classified as ordinary guaranteed payments regardless of what they represent

C. Section 736 does not apply to liquidating payments and instead defers entirely to state partnership dissolution law

D. Payments are classified as Section 736(b) payments for property or Section 736(a) payments taxed as a distributive share or guaranteed payment

19. Buyer acquires 100% of Target Corp's stock, an S corporation, and Buyer and the selling shareholders jointly agree to make a Section 338(h)(10) election. What is the primary tax effect of this election?

A. The target's S election is treated as automatically revoked on the closing date, with no other tax consequence to either party.

B. The transaction is treated for tax purposes as a deemed sale of target assets followed by liquidation, giving the buyer a stepped-up basis.

C. The buyer simply inherits the target's historic asset basis unchanged, exactly as occurs in an ordinary stock purchase transaction.

D. The seller's realized gain is permanently deferred until the buyer eventually resells the acquired assets to an outside party.

20. Acquiring Corp and Target Corp combine in a statutory merger under state law, with Target ceasing to exist and its shareholders receiving Acquiring Corp voting stock plus cash equal to 15% of total consideration. Which reorganization type does this transaction most likely qualify as?

A. A Type A reorganization, a statutory merger permitting a flexible mix of stock and other consideration under state merger law.

B. A Type B reorganization, which requires solely voting stock and prohibits any cash or other boot in the exchange.

C. A Type C reorganization, which requires substantially all of Target's assets to be acquired for voting stock alone.

D. A Type F reorganization, limited to a mere change in identity, form, or place of a single corporation.

21. Distributing Corp transfers a portion of its assets to newly formed Controlled Corp in exchange for all of Controlled's stock, then distributes that stock to Distributing's shareholders, who retain their existing Distributing Corp stock as well. Which reorganization best describes this transaction?

A. Type B reorganization, because stock of Controlled Corp is exchanged solely for Distributing Corp voting stock.

B. Type C reorganization, because substantially all of Distributing Corp's assets are transferred to Controlled Corp.

C. Type E reorganization, because the transaction recapitalizes Distributing Corp's outstanding capital structure.

D. Divisive Type D reorganization, because assets are transferred to a controlled corporation whose stock is then distributed to shareholders.

22. A corporation exchanges its outstanding preferred stock for newly issued common stock of the same corporation, with no other corporation involved and no change in the corporation's assets or business. Which reorganization type describes this transaction?

A. Type D reorganization, involving a transfer of assets between two related corporations.

B. Type E reorganization, a recapitalization involving only a single corporation's own capital structure.

C. Type F reorganization, a mere change in identity, form, or place of organization.

D. Type C reorganization, an acquisition of substantially all assets for voting stock.

23. A corporation reincorporates in a different state, keeping identical shareholders, assets, liabilities, and business operations, solely to take advantage of more favorable state corporate law. Which reorganization type describes this change?

A. Type F reorganization, a mere change in identity, form, or place of organization of one corporation.

B. Type A reorganization, a statutory merger of two previously unrelated corporations under state law.

C. Type D reorganization, a transfer of assets to a newly formed controlled corporation.

D. Type B reorganization, an acquisition of stock solely in exchange for voting stock.

24. An S corporation's election terminated because a transfer agent mistakenly issued a second class of stock without the corporation's knowledge or consent. The corporation promptly corrects the error upon discovery. Under IRC Section 1362(f), what relief may the IRS grant?

A. No relief is available; the corporation must wait five years before making a new S election.

B. The IRS may only waive the termination for future years, never retroactively to the termination date.

C. The IRS may grant inadvertent termination relief, treating the S election as having continued without interruption.

D. Relief requires unanimous shareholder consent filed with the IRS within thirty days of discovery.

25. A corporation intended to be taxed as an S corporation from its formation but failed to timely file Form 2553. It has since filed all returns consistently as an S corporation and can show reasonable cause for the late filing. What relief is generally available?

A. None; a missed Form 2553 deadline can only be cured through a formal private letter ruling request.

B. The corporation must convert to a partnership for the missed period, then re-elect S status prospectively.

C. Relief is limited strictly to corporations that discover the error within thirty days of the deadline.

D. Simplified late-election relief under Rev. Proc. 2013-30 allows retroactive S status upon a showing of reasonable cause.

26. A calendar-year C corporation had a $200,000 tax liability in the current year and paid estimated tax installments totaling only $120,000 by the applicable due dates. Which form does the corporation use to compute any underpayment of estimated tax penalty, and what is the general safe harbor to avoid it?

A. Form 2220; paying timely installments totaling at least 100% of the current year's tax liability generally avoids the penalty.

B. Form 4562; paying at least 50% of the prior year's tax liability in a single installment avoids the penalty.

C. Form 1120-W; the penalty is waived entirely if the corporation requests an automatic extension of time to file.

D. Form 8752; the penalty applies only if the underpayment exceeds $10,000 for the tax year.

27. A corporation is closely held, with five or fewer individuals owning more than 50% of its stock at some point during the last half of the tax year, and more than 60% of its adjusted ordinary gross income consists of dividends, interest, rents, and royalties. Assuming the income is not distributed, what tax may apply?

A. The accumulated earnings tax, imposed on earnings retained beyond the reasonable needs of the business.

B. The personal holding company tax, imposed at 20% on undistributed personal holding company income.

C. The built-in gains tax, imposed on appreciated assets sold within the recognition period after conversion.

D. The alternative minimum tax, imposed on corporate preference items in excess of the exemption amount.

28. A closely held corporation is funded almost entirely with shareholder advances documented as long-term notes, has an extremely high debt-to-equity ratio, pays interest only when the corporation has available cash, and the notes are subordinate to outside creditors. Which outcome is most likely upon IRS examination?

A. The IRS will automatically respect the advances as debt because they are documented with formal promissory notes.

B. The advances will be treated as tax-exempt gifts from the shareholders rather than as debt or equity.

C. The IRS may recharacterize the advances as equity, disallowing interest deductions and treating payments as dividends.

D. The corporation may deduct the payments as ordinary business expenses regardless of how the advances are structured.

29. Parent Corp owns 85% of the vote and value of Subsidiary Corp's only class of outstanding stock, and both are includible domestic corporations. If Parent and Subsidiary elect to file a consolidated federal income tax return, how is a gain on a sale of property between the two members generally treated?

A. The gain is generally deferred and not currently recognized on the consolidated return until a triggering event occurs.

B. The gain is recognized immediately in full, exactly as it would be between unrelated third parties.

C. The gain is permanently excluded from income and never recognized under any circumstances by either party.

D. The gain must be reported separately on each corporation's own standalone, unconsolidated tax return.

30. A shareholder of a closely held C corporation sells stock to the corporation's ESOP, which after the sale owns at least 30% of the corporation's outstanding stock. The shareholder reinvests the proceeds in qualified replacement property within the required period. Under IRC Section 1042, what tax treatment applies to the shareholder's gain?

A. The gain is taxed immediately at ordinary income rates with no deferral available under any circumstances.
B. The gain is taxed immediately at capital gains rates regardless of any reinvestment made by the shareholder.
C. The gain may be deferred through a tax-free rollover into qualified replacement securities under Section 1042.
D. The gain is permanently excluded from income solely because the buyer is a qualified retirement plan.

31. An individual shareholder holds qualifying Section 1244 small business stock issued directly by the corporation and sustains a total loss on the stock in the current year. The individual is married and files a joint return. What is the maximum amount of the loss that may be treated as an ordinary loss for the year?

A. $25,000, matching the passive activity loss allowance available to active real estate participants.
B. $250,000, matching the general capital loss carryover limitation applicable to joint filers.
C. $3,000, matching the standard annual net capital loss deduction limit against ordinary income.
D. $100,000, the maximum ordinary loss allowed on qualifying Section 1244 stock for joint filers.

32. An individual acquired qualified small business stock at original issue from a qualifying C corporation in 2020 and has held it for more than five years before selling it at a substantial gain. Assuming all Section 1202 requirements are met, what portion of the gain may generally be excluded from gross income?

A. 50% of the gain, subject to a flat 28% tax rate on the includible portion.
B. Up to 100% of the gain, subject to the greater-of-$10-million-or-10-times-basis limitation.
C. 20% of the gain, treated the same as the standard long-term capital gain rate.
D. None of the gain, since Section 1202 applies only to S corporation stock.

33. An S corporation with accumulated earnings and profits from prior C corporation years makes a cash distribution to its sole shareholder that exceeds the corporation's accumulated adjustments account (AAA) balance but does not exceed the shareholder's stock basis. How is the portion of the distribution exceeding AAA generally treated?

A. It is treated entirely as a nontaxable return of capital, reducing the shareholder's stock basis to zero.
B. It is treated as an ordinary loss deduction available to the distributing S corporation itself.
C. It is treated as additional wage income subject to payroll tax withholding requirements.
D. It is treated as a taxable dividend to the extent of the corporation's accumulated earnings and profits.

34. A member of a multi-member LLC taxed as a partnership actively manages the business, makes daily operating decisions, and works full-time for the LLC, unlike a traditional limited partner with no management role. How is this member's distributive share of ordinary trade or business income generally treated for self-employment tax purposes?

A. It is automatically exempt from self-employment tax because LLC members receive limited liability protection under state law.
B. It is exempt only if the member's capital account exceeds the average of the other members' capital accounts.
C. It is generally subject to self-employment tax because the member functions like a general partner, not a passive investor.
D. It is subject to self-employment tax only on guaranteed payments, never on the distributive share itself.

35. In an otherwise qualifying tax-free corporate reorganization, a shareholder exchanges Target Corp stock for Acquiring Corp stock plus a modest amount of cash boot. The shareholder's realized gain on the exchange exceeds the amount of cash received. How much gain must the shareholder recognize?

A. Gain is recognized only to the extent of the cash boot received, not the full realized gain.
B. Gain is recognized in full immediately, exactly as if no reorganization provision applied at all.
C. No gain is ever recognized when any stock at all is received in the exchange.
D. Gain is recognized only if the boot exceeds fifty percent of total consideration received.

36. A firm of engineers that provides services on a fee basis uses the accrual method and typically experiences delays and nonpayment on some client invoices. Under IRC Section 448(d)(5), what does the nonaccrual-experience method allow this type of service-based accrual taxpayer to do?

A. Deduct a reserve for bad debts based on prior years' loss experience

B. Exclude from accrued income amounts not expected to be collected, based on the business's own experience, without accruing them first

C. Switch permanently to the cash method regardless of gross receipts

D. Deduct estimated uncollectible amounts using the specific charge-off method before any income is earned

37. A calendar-year accrual-basis employer accrues $40,000 of vacation pay that vested for employees on December 31, 2025, but does not pay it out until March 20, 2026. When may the employer deduct the $40,000?

A. In 2025, the year the vacation pay vested, regardless of payment date

B. Ratably over 2025 and 2026 based on days elapsed

C. In 2026, the year actually paid, because payment occurred more than 2.5 months after year-end

D. In 2024, the year immediately preceding vesting

38. An accrual-basis S corporation accrues a $20,000 bonus payable to its majority shareholder-employee, who reports on the cash method, at December 31. The shareholder actually receives the payment on February 10 of the following year. Under IRC Section 267(a)(2), when may the corporation deduct the accrued bonus?

A. Not until the year the shareholder actually includes the payment in income, the following year

B. In the current year, matching the corporation's own accrual-method deduction timing

C. Ratably over the two tax years surrounding the payment date

D. In the year the compensation liability was originally accrued, regardless of the shareholder's method

39. A cash-method business pays $6,000 in points to obtain a 10-year business loan used to purchase real property for the business. How must these points generally be treated for federal tax purposes?

A. Deducted in full in the year paid as prepaid interest under the general cash-method rule

B. Capitalized and deducted ratably as interest expense over the 10-year term of the loan

C. Deducted immediately as a cost of financing under Section 195

D. Added to the basis of the real property and recovered through depreciation

40. A corporation reimburses a newly hired, non-military employee $8,000 for costs of relocating to accept the job, in an arrangement that meets none of the narrow exceptions preserved after the Tax Cuts and Jobs Act. How must this reimbursement generally be treated for federal tax purposes?

A. Excludable from the employee's income as a qualified fringe benefit

B. Deductible by the employer but entirely nontaxable to the employee under an accountable plan

C. Excludable up to $3,000 with the remainder taxable as wages

D. Fully includible in the employee's taxable wages, though still deductible by the employer as compensation

41. A business without an applicable financial statement (AFS) has a written accounting policy at the start of the year to expense items costing $2,000 or less. During the year it purchases 50 identical pieces of equipment at $1,800 each. Assuming the de minimis safe harbor election is properly made, how are these purchases treated?

A. All $90,000 must be capitalized because the aggregate cost exceeds the safe harbor ceiling

B. Only the first $2,500 of purchases may be expensed, with the rest capitalized

C. Each item may be currently deducted, since its per-item cost is below the applicable $2,500 no-AFS threshold

D. None of the cost may be expensed because equipment is a listed property class ineligible for the safe harbor

42. A manufacturing business performs cleaning, inspection, and lubrication of a piece of production equipment approximately every three years, work it reasonably expects to repeat more than once during the equipment's class life. Under the routine maintenance safe harbor, how is this recurring cost generally treated?

A. It must be capitalized because any work restoring equipment to operating condition is an improvement

B. It qualifies only if performed annually without exception

C. It is deductible solely under the small taxpayer safe harbor's dollar cap

D. It may generally be currently deducted rather than capitalized, since it is expected to recur more than once over the property's class life

43. A qualifying small business (average annual gross receipts of $9 million for the prior three years) owns a building with an unadjusted basis of $400,000. During the year it incurs $7,500 of repair and improvement costs on the building. Under the small taxpayer safe harbor, how are these costs treated?

A. Fully capitalized because they exceed the $10,000 flat statutory cap

B. Currently deductible, since $7,500 is less than the lesser of 2% of unadjusted basis ($8,000) or $10,000

C. Currently deductible only if the taxpayer also elects the de minimis safe harbor

D. Capitalized because the safe harbor applies only to taxpayers with gross receipts under $5 million

44. A regional chain of coffee shops already operating ten locations decides to open an eleventh location in a new city within the same line of business, incurring $15,000 investigating and setting up the new store. How are these costs treated, compared to a brand-new entrepreneur's costs of investigating whether to enter the coffee shop business for the first time?

A. Currently deductible as ordinary expansion expenses, since the chain already operates the business, unlike the entrepreneur's capitalized Section 195 start-up costs.

B. Both taxpayers must capitalize their costs identically under Section 195, since store-opening costs are always start-up expenditures

C. The existing chain must amortize its costs over 180 months, while the new entrepreneur may deduct them immediately

D. Neither taxpayer may deduct or amortize these costs because both relate to physical retail locations

45. Since the Tax Reform Act of 1986, most accrual-method businesses may no longer deduct bad debts by estimating and reserving for future losses in advance. Which method must these businesses generally use instead, and which category of taxpayer retains a notable exception to this general prohibition?

A. The direct write-off method must be used, with no exceptions permitted for any taxpayer

B. The percentage-of-sales method must be used, except for retailers, who may still use the reserve method

C. The specific charge-off method must be used; certain small banks and thrift institutions remain a notable exception permitted to use the reserve method

D. The completed-contract method must be used, except for taxpayers with average gross receipts above the small business threshold

46. A calendar-year accrual-basis business wants to deduct a recurring liability accrued at year-end even though economic performance technically has not yet occurred by the filing date. Under the recurring item exception to the economic performance requirement, which condition must generally be satisfied, in addition to the item being recurring and consistently treated?

A. Economic performance must occur within 8.5 months after year-end, and the item must be immaterial or produce a better income-expense match.

B. The liability must be paid in full using cash before the original due date of the return, without extensions

C. The taxpayer must obtain advance written consent from the IRS before applying the exception in any year

D. The item must relate exclusively to inventory costs subject to Section 263A

47. A construction contractor enters into a long-term contract expected to take 18 months to complete. The contractor's average annual gross receipts for the preceding three years are $20 million. Which accounting method may this contractor use for this contract under the small contractor exception?

A. Only the percentage-of-completion method, since all long-term contracts exceeding one year require it

B. Either the completed-contract method or another exempt method, since the term is short and receipts fall within the threshold.

C. Only the cash method, regardless of the contract's duration or gross receipts

D. Only the accrual method with mandatory inventory capitalization under Section 263A

48. A business issues a bond with original issue discount (OID) to a lender. Regardless of whether the business otherwise uses the cash or accrual method of accounting, how must it treat the OID?

A. It may defer the entire discount until the bond matures, regardless of accounting method used

B. It may deduct the discount fully in the year the bond is issued, matching cash-method treatment

C. It is treated as taxable gain to the borrower and excluded from the lender's income entirely

D. It must generally accrue and deduct the discount annually over the life of the bond as interest expense, regardless of the taxpayer's overall accounting method

49. A calendar-year accrual-basis business owns real property in a jurisdiction that assesses property tax for a fiscal period spanning July 1 through June 30. Absent a special election, real property taxes generally accrue on the date they become a fixed and certain liability under local law. What election under Section 461(c) instead allows the business to deduct the tax ratably over the period to which it relates?

A. The Section 481(a) adjustment election, spreading the liability over four years

B. The ratable accrual election, allocating the property tax deduction evenly across the period to which it relates.

C. The completed contract election, deferring the entire tax until the property is sold

D. The mark-to-market election, recognizing the liability at fair value each quarter

50. A nondealer sells business real property at a gain, with part of the sale price payable in future tax years. Absent an election to the contrary, how must the seller generally report the resulting gain?

A. The entire gain must be reported in the year of sale, regardless of when payments are received

B. Gain is reported only in the final year payments are collected, deferring all earlier recognition

C. The installment method applies automatically only if the seller is a dealer in real property

D. Gain is reported proportionately as each payment is received, using the gross profit ratio, unless the seller affirmatively elects out of the installment method

51. A corporation elects the Alternative Simplified Credit (ASC) method for computing its research credit. Its qualified research expenses (QREs) for the current year are $800,000, and its average QREs for the three preceding tax years are $500,000. Which formula correctly describes how the ASC is computed in this situation?

A. 14% of the amount by which current-year QREs exceed 50% of the average QREs for the three preceding tax years

B. 20% of the amount by which current-year QREs exceed a fixed-base percentage of average gross receipts for prior years

C. 6% of current-year QREs, a flat rate applying only when there were no QREs in any of the three prior years

D. 14% of total current-year QREs, applied without any reduction for research spending in prior years at all

52. An employer establishes an on-site childcare facility for its employees and also contracts with a childcare resource and referral service. Which statement correctly describes how the Section 45F employer-provided childcare credit is computed?

A. The credit equals 35% of qualified childcare facility expenditures plus 15% of resource and referral expenditures

B. The credit equals a flat 20% of all childcare-related expenditures, with no separate referral component

C. The credit equals 25% of qualified childcare expenditures plus 10% of qualified resource and referral expenditures

D. The credit equals 10% of qualified childcare expenditures plus 25% of resource and referral expenditures

53. A business claimed an energy investment credit on qualifying property and disposed of the property two years later, before the end of the credit's five-year recapture period. What is the general effect of this early disposition?

A. A portion of the credit must be recaptured, with the recapture percentage decreasing by 20% for each full year held

B. The entire original credit remains permanently allowed regardless of when the property is later disposed of

C. The disposition triggers an amended return requirement, but no additional recapture tax is ever owed

D. The credit is recaptured only if the property is sold to a related party within the period

54. A taxpayer owns a working interest in a mineral property and is comparing cost depletion to percentage depletion for the current tax year. Which statement correctly distinguishes the two methods?

A. Cost depletion may be deducted after the property's adjusted basis reaches zero, while percentage depletion cannot

B. Both methods are capped at the property's remaining adjusted basis for the current tax year

C. Percentage depletion may continue after the property's adjusted basis reaches zero, while cost depletion cannot exceed it

D. Percentage depletion is available only for timber property, while cost depletion applies to other resources

55. A taxpayer's mineral property has an adjusted basis for depletion of $600,000 and estimated recoverable units of 300,000 tons. During the current year, 50,000 tons were extracted and sold. What is the cost depletion deduction for the year?

A. $60,000

B. $100,000

C. $120,000

D. $150,000

56. For purposes of the Qualified Business Income deduction, which of the following trades or businesses is specifically excluded from the definition of a specified service trade or business (SSTB), despite involving significant professional expertise?

A. Health services provided directly by a licensed physician

B. Consulting services provided to businesses for a fee

C. Financial services provided by an investment advisory firm

D. Architecture services provided by a licensed architect

57. An individual sells depreciable equipment to a corporation in which she owns 60% of the outstanding stock, recognizing a $30,000 gain that would ordinarily be eligible for capital gain treatment. How is this gain characterized under Section 1239?

A. The gain is treated as long-term capital gain since the equipment was held over one year

B. The gain is treated as Section 1231 gain, netted with other Section 1231 transactions

C. The gain is treated entirely as ordinary income because the parties exceed the 50%-ownership threshold

D. The gain is treated as ordinary income only up to prior depreciation, with the rest as capital gain

58. A business purchases a new qualified commercial clean vehicle for use in its delivery operations and wants to claim the Section 45W commercial clean vehicle credit. Which feature distinguishes this credit from the Section 30D new clean vehicle credit available to individual consumers?

A. Section 45W requires the vehicle to be assembled in North America, while Section 30D has no such rule

B. Section 45W has no final assembly or battery-component sourcing requirements, while Section 30D imposes both

C. Section 45W is available only to individual taxpayers, while Section 30D is available only to businesses

D. Section 45W caps the credit at $2,500 per vehicle, while Section 30D allows up to $10,000

59. A timber owner incurs $14,000 of qualifying reforestation expenditures on a single qualified timber property during the current tax year. How are these costs generally treated under Section 194?

A. All $14,000 must be capitalized and recovered only when the timber is eventually harvested and sold

B. The entire $14,000 is amortized ratably over 15 years beginning in the year incurred

C. The entire $14,000 is immediately deductible in the year incurred, with no dollar limitation

D. Up to $10,000 is immediately deductible, and the remaining $4,000 is amortized over 84 months

60. A business purchases used manufacturing equipment from an unrelated third party in an arm's-length transaction and wants to claim bonus depreciation on the acquisition. Which condition must be satisfied for the used property to qualify?

A. The taxpayer or a predecessor must not have used the property at any time before the acquisition

B. The property must have been placed in service by its original owner within the same tax year

C. The property must be acquired from a related party to ensure an accurate basis carryover

D. The property must cost less than $25,000 to qualify under the used-property bonus rules

61. A sole proprietor purchases off-the-shelf computer software for use in her business and wants to know whether it qualifies for Section 179 expensing. Which statement is correct?

A. Off-the-shelf software never qualifies for Section 179 because it is treated as an intangible asset
B. Off-the-shelf software qualifies for Section 179 only if custom-developed for the taxpayer's business
C. Off-the-shelf computer software is specifically included in the definition of qualifying Section 179 property
D. Off-the-shelf software qualifies for bonus depreciation but is permanently excluded from Section 179

62. A business acquires goodwill and going-concern value as part of purchasing another company's assets. How is the cost of these Section 197 intangible assets generally recovered for tax purposes?

A. The cost is amortized over the intangible's actual estimated useful life per an independent appraisal
B. The cost is deducted immediately in the year acquired, similar to Section 179 property
C. The cost is depreciated using MACRS over a 5-year period with a half-year convention
D. The cost is amortized ratably on a straight-line basis over a fixed 15-year period

63. An employer hires a certified member of a Work Opportunity Tax Credit targeted group who works 500 hours during the first year of employment. Assuming qualified first-year wages of $6,000, what is the general credit amount for this employee?

A. $1,500
B. $2,400
C. $3,000
D. $4,200

64. A small business with average annual gross receipts under $1 million incurs $6,000 of eligible expenditures to make its facility more accessible to individuals with disabilities. How is the Section 44 disabled access credit generally computed on these expenditures?

A. 50% of the eligible expenditures exceeding $250, up to a maximum credit of $5,000
B. 100% of all eligible expenditures, with no minimum threshold or maximum credit limit

C. 25% of eligible expenditures exceeding $10,250, up to a maximum credit of $2,500
D. 50% of eligible expenditures exceeding $1,000, up to a maximum credit of $10,000

65. A small employer with 40 or fewer employees establishes a new qualified retirement plan and incurs eligible startup costs. Which statement correctly describes the Section 45E credit available for these costs?

A. The credit covers a percentage of eligible startup costs for the new plan, subject to a per-year dollar cap
B. The credit fully reimburses all startup and ongoing administrative costs indefinitely, with no limitation
C. The credit is available only to employers with more than 100 employees adding a new plan
D. The credit applies solely to costs of terminating an existing plan, not starting a new one

66. A sole proprietor is starting a business that will have employees and needs to obtain an Employer Identification Number (EIN). Which statement correctly describes the application process?

A. The application must be filed on paper Form SS-4 and mailed to the IRS at least 60 days before wages are first paid.
B. The online EIN application is available to the responsible party and, once the information validates, issues the EIN immediately upon completion.
C. An EIN can be transferred from a previously dissolved corporation to a new sole proprietorship to avoid a new application.
D. A business may operate for up to one year using its owner's Social Security Number before an EIN becomes mandatory.

67. An employer files all four quarterly Forms 941 for a calendar year on time, with the first three filed well before their respective due dates. For purposes of the assessment statute of limitations under Section 6501, when is the employer's employment tax liability for that entire calendar year treated as having been filed?

A. Each quarterly return has its own separate three-year period beginning on that quarter's actual filing date.

B. The assessment period begins on the date the fourth and final quarterly return was actually filed.
C. The assessment period begins on the date the first quarterly return for the year was actually filed.
D. All four quarterly returns are deemed filed on April 15 of the following year, starting one assessment period.

68. A business has been treating a group of workers as independent contractors but now believes they should have been classified as employees. The business has never been audited on this issue, has filed all required Forms 1099-NEC, and wants to begin treating the workers as employees for future periods while limiting its exposure for the past. Which IRS program allows this in exchange for paying a small percentage of one year's liability with no interest or penalties?

A. The Fresh Start Initiative, which restructures installment agreements for businesses with existing employment tax debt.
B. An Offer in Compromise, which settles the entire outstanding federal tax liability for less than the full balance.
C. The Voluntary Classification Settlement Program, which allows reclassification for about 10% of one year's liability.
D. Section 530 relief, which grants a permanent safe harbor to continue independent contractor treatment despite an audit.

69. An employer's FUTA tax liability exceeded $500 for the year, and the employer made all required quarterly FUTA deposits by their due dates. By what date must the employer file Form 940 for that calendar year?

A. March 15 of the following year, matching the due date for partnership and S corporation returns.
B. February 10 of the following year, because all required deposits were made on time during the year.
C. January 31 of the following year, regardless of whether deposits were made on time.
D. April 15 of the following year, matching the individual income tax filing deadline.

70. By what date must an employer generally furnish Form W-2 to each employee reporting the preceding calendar year's wages?

A. January 31 of the year following the calendar year in which the wages were paid to the employee.

B. February 28 of the year following the calendar year in which the wages were paid to the employee.

C. March 31 of the year following the calendar year, matching an outdated paper-filing deadline no longer in effect.

D. April 15 of the year following the calendar year, matching the individual income tax return deadline.

71. An employee covered under her employer's group health plan is terminated for reasons other than gross misconduct. Assuming the employer is subject to COBRA, what is the maximum period for which the former employee may generally elect to continue the same group coverage at her own expense?

A. 12 months from the date employment ended, non-extendable for any reason.

B. 24 months from the date employment ended, matching unemployment insurance benefit periods.

C. 18 months from the date employment ended, extendable to 29 months in certain disability situations.

D. 36 months from the date employment ended, the same period available to a surviving spouse.

72. An employer that is normally a monthly depositor accumulates $110,000 of employment tax liability on a single day during the month. Under the federal deposit rules, what must the employer do?

A. Continue depositing on the regular monthly schedule because the monthly election controls regardless of amount.

B. Wait until the semiweekly deposit date that would otherwise apply under the standard lookback calculation.

C. Deposit only the excess over $100,000 by the next business day, and the rest on the normal schedule.

D. Deposit the entire accumulated amount by the next business day and become a semiweekly depositor going forward.

73. Which of the following statements correctly describes the federal employment tax treatment of third-party sick pay?

A. Third-party sick pay is entirely exempt from federal income tax withholding and both shares of FICA.

B. The employee automatically becomes responsible for remitting both the employee and employer shares of FICA.

C. Sick pay paid by a third party is generally subject to FICA unless paid over six months after the employee last worked.

D. Only the employee share of FICA applies to third-party sick pay, and the employer share is permanently waived.

74. A self-employed plumber performs all repair and installation work at customers' homes and has no other fixed business location. He uses a spare room in his own home exclusively and regularly to schedule appointments, order supplies, and handle billing and bookkeeping for the business. Does this room qualify as his principal place of business for the home office deduction?

A. No, because the deduction is available only when income-producing services are physically performed inside the home.

B. No, because a home office can never qualify as a principal place of business for a trade involving off-site fieldwork.

C. Yes, but only if the room is also used as personal living space for at least part of each day.

D. Yes, because he exclusively and regularly conducts the business's administrative and management activities there with no other fixed location.

75. For how long should an employer generally retain records related to federal employment taxes, such as the amounts and dates of wage payments and tax deposits?

A. At least 2 years from the date the related employment tax return was filed.

B. At least 4 years after the date the tax becomes due or is paid, whichever is later.

C. At least 3 years from the close of the calendar year in which wages were paid.

D. At least 7 years from the date the employee's employment with the business ended.

76. An employer pays an employee a $5,000 year-end bonus separately from her regular wages, and her total supplemental wages for the year remain well under $1 million. Assuming regular income tax was withheld from her wages earlier in the year, at what flat rate may the employer withhold federal income tax from this bonus?

A. 22 percent, the optional flat rate for supplemental wages under $1 million paid separately from regular wages.

B. 15 percent, the flat rate that applies to all supplemental wage payments regardless of amount or timing.

C. 28 percent, the flat rate reserved for supplemental wages paid only to highly compensated employees.

D. 37 percent, the mandatory flat rate that applies to every supplemental wage payment made during the year.

77. A sole proprietor employs her 16-year-old son in the business, paying him reasonable wages for after-school work. Which statement correctly describes the federal payroll tax treatment of these wages?

A. The wages are entirely exempt from federal income tax withholding as well as FICA and FUTA.

B. The exemption from FICA tax applies only if the business is organized as a corporation.

C. The wages are subject to full FICA tax but are exempt from FUTA tax until age 21.

D. The wages are exempt from FICA tax because the son is under 18 and the business is a sole proprietorship.

78. Company A acquires substantially all of Company B's business assets mid-year and immediately continues to employ Company B's workforce in the same positions. If Company A properly qualifies as a successor employer, what is the effect on the Social Security and FUTA wage bases for the acquired employees?

A. Company A must restart each employee's wage base at zero, disregarding wages Company B already paid that year.

B. Company A may credit wages Company B already paid those employees that year toward each wage base for the year.

C. Company A may credit prior wages toward the FUTA wage base only, never toward the Social Security wage base.

D. Company A must obtain a private letter ruling before crediting any wages Company B paid toward the wage base.

79. How must an employer generally make its federal payroll tax deposits to the IRS?

A. Electronically, through the Electronic Federal Tax Payment System (EFTPS), which is mandatory for virtually all depositors.

B. By mailing a paper Form 8109 deposit coupon directly to the employer's local IRS service center.

C. In person, by delivering a cashier's check to an IRS Taxpayer Assistance Center before the deposit due date.

D. By wiring funds directly to the U.S. Treasury's general account without using any IRS-designated payment system.

80. A homeowner transfers a personal residence into an irrevocable trust, retaining the right to live in the home rent-free for a fixed term of years, after which the residence passes to her children. What estate planning vehicle does this describe, and what is its primary transfer-tax benefit?

A. A grantor retained annuity trust, which converts personal residence equity into a fixed annuity stream taxed annually to the grantor

B. A charitable remainder trust, which removes the residence from the grantor's estate in exchange for a current income tax deduction

C. A qualified personal residence trust, which removes future appreciation from the grantor's estate while valuing the gift below the home's fair market value

D. An intentionally defective grantor trust, which shifts income tax liability to the beneficiaries while retaining estate inclusion for the grantor

81. A business owner transfers closely held stock expected to appreciate substantially into an irrevocable trust in exchange for a fixed annuity payable to the owner for a term of years, with any remaining trust value passing to her children at the term's end. If the trust's growth exceeds the IRS Section 7520 assumed rate, what is the primary tax advantage of this technique?

A. Any appreciation above the Section 7520 rate passes to the remainder beneficiaries with little or no additional gift tax

B. The owner permanently avoids capital gains tax on the stock's appreciation regardless of when the trust terminates

C. The stock receives a full step-up in basis to fair market value immediately upon the trust's funding

D. The annuity payments received by the owner are entirely excluded from her gross income each year

82. A grantor sells a business interest to an irrevocable trust that is treated as a grantor trust for income tax purposes but is designed to be excluded from the grantor's taxable estate, receiving an installment note in return. What is the tax result of this sale between the grantor and the trust?

A. The grantor recognizes immediate capital gain on the full appreciation in the business interest at the time of sale

B. The trust must recognize ordinary income equal to the difference between the note's face value and the interest's basis

C. No gain or loss is recognized because the grantor and the grantor trust are treated as the same taxpayer for income tax purposes

D. The installment note payments are treated as taxable distributions from the trust back to the grantor each year

83. An estate includes qualified farmland that the decedent's family has operated for generations, and a qualified heir will continue farming the property after death. Electing special use valuation under Section 2032A allows the estate to value this real property based on what standard, rather than its highest and best use?

A. The property's original acquisition cost adjusted only for depreciation claimed during the decedent's ownership

B. The property's actual value in its qualified farm or business use, subject to a statutory reduction cap

C. The average of three independent appraisals obtained within six months before the decedent's date of death

D. The replacement cost of comparable farmland located within the same county as the decedent's property

84. A landowner grants a qualified organization a perpetual restriction on the future use and development of a scenic tract of land, retaining ownership but permanently limiting the property's development potential. To claim a charitable deduction for this contribution, what must the donated easement satisfy?

A. The restriction must last for a minimum renewable period of twenty-five years before it may lapse

B. The donee organization must resell the easement interest within five years to a government agency

C. The landowner must retain the right to terminate the restriction at any time after ten years

D. The easement must be granted in perpetuity to a qualified organization for a recognized conservation purpose

85. A farmer sells farmland to her adult son on the installment method, and within eighteen months the son resells the land to an unrelated buyer for cash. Under the related-party installment sale rules, what is the general tax consequence to the farmer-mother?

A. The mother must generally accelerate and recognize the remaining deferred gain as of the date of the son's resale

B. The mother's installment sale is automatically voided, and the original transaction is treated as a completed gift

C. The son becomes personally liable for the mother's deferred gain because he is the second seller in the chain

D. No acceleration occurs because related-party sales are entirely exempt from the second-disposition acceleration rule

86. A taxpayer owns and operates both a restaurant and a separate laundromat, each conducted through its own disregarded single-member LLC, and the two locations share common management and complementary hours of operation. Under the passive activity grouping rules, what may the taxpayer generally do with these two undertakings?

A. Nothing; each LLC must always be tested separately for material participation regardless of any shared factors

B. Combine them into a single activity for material participation testing if they form an appropriate economic unit

C. Combine them only after obtaining a private letter ruling approving the proposed grouping in advance

D. Combine them automatically the moment both entities file returns using the same employer identification number

87. A taxpayer wants to establish material participation in a business activity to avoid passive activity loss limitations, without relying on the real estate professional rules. Which of the following independently satisfies one of the seven material participation tests under the regulations?

A. Participating in the activity for at least 100 hours during the year, more than any other individual

B. Owning at least a 10% capital or profits interest in the activity throughout the entire tax year

C. Delegating all day-to-day management decisions to a professional property manager hired by the taxpayer

D. Participating in the activity for more than 500 hours during the tax year

88. A dentist owns a building personally and rents it to her own wholly owned dental practice at fair market rent, generating net rental income for the year. Under the self-rental rule, how is this rental income generally treated for passive activity purposes?

A. It remains fully passive income, freely available to absorb losses from the taxpayer's other passive activities

B. It is excluded from income entirely because the property is used in the taxpayer's own trade or business

C. It is recharacterized as nonpassive income, so it cannot be offset by the taxpayer's passive losses

D. It is treated as self-employment income subject to Social Security and Medicare tax on the net rent

89. A participant in an employer's 401(k) plan wants to borrow against her vested account balance of $120,000. Assuming the plan permits loans, what is the maximum amount she may generally borrow under the Internal Revenue Code loan limits?

A. $100,000, the flat statutory ceiling that applies regardless of the participant's vested balance

B. $50,000, the lesser of $50,000 or 50% of the participant's vested account balance

C. $60,000, exactly half of the participant's total vested account balance with no dollar cap

D. $120,000, the full vested balance, since plan loans are not subject to any statutory limit

90. An IRA owner turns 73 during the current tax year and has not yet taken any required minimum distributions. By what date must she take her first required minimum distribution without incurring an excise tax on the shortfall?

A. December 31 of the year in which she turns 72, regardless of her actual birth date

B. April 15 of the year following the year she turns 73, matching the individual filing deadline

C. December 31 of the year immediately preceding the year she turns 73

D. April 1 of the year following the year in which she turns 73

91. A religious denomination maintains a retirement plan for its ministers and lay employees, and the plan has not made an affirmative election to be covered by ERISA. How is this church plan generally treated under federal retirement plan law?

A. It must comply with all ERISA funding, vesting, and fiduciary requirements identical to a corporate pension plan

B. It automatically loses its tax-qualified status unless it voluntarily elects ERISA coverage within one year

C. It is generally exempt from ERISA's participation, vesting, funding, and fiduciary provisions unless it elects coverage

D. It is treated as a governmental plan, exempt from income tax withholding on all distributions made

92. A tax-exempt university uses borrowed funds to purchase an office building that it then leases to unrelated tenants, generating rental income while the acquisition debt remains outstanding. How is this rental income generally treated under the unrelated business income tax rules?

A. A percentage of the rental income proportionate to the acquisition indebtedness is treated as unrelated debt-financed income

B. The rental income is entirely excluded from unrelated business income because real property rents are always exempt

C. The rental income is fully taxable regardless of whether any acquisition debt was used to buy the building

D. The rental income is exempt as long as the building is used for at least one exempt purpose

93. A public charity is organized and operated exclusively to support one or more specified publicly supported organizations, and it must be classified into one of three types based on its relationship with those organizations. Which of the following correctly distinguishes the three supporting organization types?

A. Type I is governed entirely by donors, Type II by the IRS, and Type III by state attorneys general

B. Type I applies only to hospitals, Type II only to universities, and Type III only to religious organizations

C. All three types are functionally identical and differ only in the number of organizations they support

D. Type I and II involve a governance relationship with the supported organization, while Type III is operated in connection with, but not controlled by, it

94. A decedent dies survived by a spouse, and the decedent's estate does not use the entire applicable exclusion amount. To allow the surviving spouse to use the decedent's unused exclusion amount against her own future estate and gift taxes, what must the decedent's executor do?

A. Timely file a Form 706 for the decedent's estate and make the portability election, even if no estate tax is otherwise due

B. Do nothing, since the deceased spousal unused exclusion transfers automatically to the surviving spouse by operation of law

C. File a joint gift tax return with the surviving spouse reporting the unused exclusion as a completed gift

D. Wait until the surviving spouse's own death, at which point the unused exclusion is combined automatically on Form 706

95. Compared to an individual taxpayer, a nongrantor trust reaches the top marginal income tax bracket at a dramatically lower level of taxable income. What is the general planning implication of this rate compression for trustees?

A. Trusts are entirely exempt from graduated rates and instead pay a single flat rate on all income

B. Rate compression only affects trusts with corporate beneficiaries, never trusts with individual beneficiaries

C. Distributing income currently to beneficiaries in lower individual brackets can reduce the overall family income tax burden

D. Trustees must always accumulate income within the trust to minimize the family's total income tax liability

96. A nongrantor trust accumulates net investment income for the year rather than distributing it to beneficiaries. At what level of undistributed net investment income does the 3.8% net investment income tax generally begin to apply to the trust itself?

A. Once undistributed net investment income exceeds the same $200,000 threshold used for single individual taxpayers

B. Once undistributed net investment income exceeds the dollar amount at which trusts reach the top income tax bracket

C. The tax never applies at the trust level, only to individual beneficiaries who receive distributions

D. Once the trust's total assets, rather than its income, exceed $250,000 at any point during the year

97. An IRA owner who is 75 years old wants to satisfy part of her required minimum distribution while also directing funds to a qualified charity without recognizing the distribution as taxable income. Which technique accomplishes both goals?

A. Taking the full RMD in cash and later claiming an itemized charitable contribution deduction for the donated amount

B. Establishing a charitable remainder trust funded with a rollover from the traditional IRA during the current year

C. Making a qualified charitable distribution directly from the IRA to the charity, up to the annual statutory limit

D. Converting the IRA to a Roth IRA and donating the converted funds to charity within sixty days

98. A private foundation and its disqualified persons together own 40% of the voting stock of a for-profit business enterprise. Under the excess business holdings rules, what is generally the maximum permitted combined holding before an excise tax applies?

A. Generally 20% of the voting stock, combining the foundation's and disqualified persons' holdings, subject to limited exceptions

B. Generally 50% of the voting stock, matching the threshold used for controlled group determinations

C. There is no percentage limit as long as the foundation itself holds a majority of the shares

D. Generally 35% of the voting stock, matching the substantially-disproportionate-redemption threshold under Section 302

99. A trustee must track three distinct income figures for a complex trust: fiduciary accounting income, distributable net income, and taxable income. How does fiduciary accounting income primarily differ from the other two figures?

A. Fiduciary accounting income and taxable income are always identical because both are computed strictly under the Internal Revenue Code
B. Fiduciary accounting income determines the trust's personal exemption amount, while DNI has no role in that calculation
C. Fiduciary accounting income is irrelevant to trust administration and is used only for state court reporting purposes
D. Fiduciary accounting income is governed by the trust instrument and state principal-and-income law, while DNI and taxable income are tax concepts

100. A farmer had a low or negative net profit from her farming operation for the year, but wants to receive Social Security earnings credit for the year. Which technique allows her to compute self-employment tax using a formula based on gross farm income rather than actual net profit?

A. The accrual method election under Section 447, which recomputes farm income using accrual accounting principles only
B. The farm optional method, which allows reporting a set percentage of gross farm income as earnings subject to self-employment tax
C. The farm income averaging election on Schedule J, which spreads current income across the three preceding base years
D. The like-kind exchange election, which defers recognition of gain on the disposition of farm business property

Answer Key and Explanations — Practice Exam 17, Part 2: Businesses

1. A — Section 704(c) prevents partners from shifting precontribution built-in gain or loss onto other partners. It requires the partnership to allocate income, gain, loss, and deduction from contributed property so the built-in amount is borne by the contributing partner, using the traditional, curative, or remedial method, not shifted among partners by the contribution itself.

2. D — The ceiling rule limits the traditional method: total tax depreciation, gain, loss, or deduction allocated among all partners can never exceed the total tax amount actually recognized by the partnership, even where book allocations call for more. Noncontributing partners may receive less tax depreciation than their book share, a distortion the curative and remedial methods address.

3. B — The curative allocation method cures ceiling rule distortions by reallocating other real partnership tax items, such as taxable income or gain unrelated to the contributed property, to partners who were shorted tax depreciation because of the ceiling rule. Unlike the remedial method, curative allocations use actual existing partnership tax items, not notional ones.

4. C — Under the remedial method, the partnership creates notional tax items with no corresponding real transaction: it allocates additional notional deduction to the noncontributing partner to match the book allocation, and simultaneously allocates offsetting notional income of the same amount to the contributing partner, fully curing the ceiling rule distortion without shorting either partner.

5. A — A deficit restoration obligation is a partner's unconditional promise to contribute capital, upon liquidation, to eliminate any deficit balance in her capital account. Under the Treasury Regulations' safe harbor, an unlimited DRO supports finding economic effect for loss and deduction allocations up to the restoration amount, because the partner genuinely bears that economic burden.

6. B — Section 465(b)(6) creates a real property exception: qualified nonrecourse financing, meaning nonrecourse debt secured by real property and borrowed from a qualified commercial lender or certain government-related sources, with no partner personally liable, is treated as an amount at risk despite being nonrecourse. This makes real estate partnerships favorable for at-risk loss deduction purposes compared to other activities.

7. D — Converting a partnership into a corporation through an assets-over rollup is tested under Section 351: the transferors, here the partnership and then the partners upon its liquidating distribution, must hold at least eighty percent of the corporation's voting stock and total shares immediately after the exchange for the incorporation to qualify as tax-free, with a carryover asset basis.

8. C — A partner's death does not close the partnership's tax year for the partnership as a whole or for surviving partners, but it does close the year with respect to the deceased partner. Her distributive share of partnership items is generally prorated through the date of death and reported on her final individual income tax return under Section 706(c).

9. D — Under Section 1014, a decedent's successor generally takes an outside basis in the partnership interest equal to its fair market value at death. That step-up does not automatically carry to the partnership's inside basis in its assets; without a Section 754 election, the inside basis stays unchanged, creating a disparity between outside basis and the share of inside basis.

10. B — Section 704(c)(1)(C) prevents duplication of a single economic loss among multiple partners: when property with a built-in loss at contribution is later sold, that built-in loss portion may be taken into account, for tax purposes, only by the contributing partner. Other partners' bases and capital accounts are adjusted so the loss is never shared or duplicated.

11. A — Ordinarily a Section 743(b) basis adjustment applies only where a valid Section 754 election is in effect. However, when a transfer of a partnership interest involves a substantial built-in loss exceeding $250,000, Section 743(b) mandates the basis adjustment regardless of any election, preventing a transferee from inheriting an inflated inside basis that duplicates an already-recognized loss.

12. C — Booking up partnership property to fair market value upon a new partner's admission creates a new disparity between book value and unchanged tax basis, separate from any original contribution. This new disparity, called reverse Section 704(c) gain or loss, is allocated among the partners who were partners before the revaluation, using the traditional, curative, or remedial methods.

13. B — A self-employed individual may generally deduct one hundred percent of health insurance premiums paid for herself, her spouse, and dependents as an above-the-line deduction, rather than an itemized deduction. The deduction cannot exceed net earnings from self-employment generated by the specific trade or business under which the plan is established, and is disallowed if other subsidized coverage is available.

14. D — A guaranteed payment for the use of a partner's capital, unlike one for services, is treated economically like interest paid to an investor. While it is ordinary income to Grace and generally deductible or capitalizable by the partnership, it is excluded from net earnings from self-employment because it does not compensate her for services actively performed for the partnership.

15. A — A qualified income offset is an alternative safe harbor to a deficit restoration obligation. Rather than requiring the partner to restore a deficit with cash, the agreement must provide that if she unexpectedly receives an allocation creating or increasing a capital account deficit, she will be allocated income and gain as quickly as possible to eliminate it, preserving economic effect.

16. C — Outside basis is generally adjusted in a set order: increased first by the partner's share of income items and additional contributions during the year, then decreased by distributions received, and finally decreased by the partner's share of losses and nondeductible expenses. This ordering matters because losses are deductible only to the extent basis remains after distributions are subtracted.

17. C — Section 704(c)(1)(B), part of the mixing bowl rules, stops partners from using a contribution followed by a distribution to shift built-in gain or loss to another partner. If contributed property is distributed to a different partner within seven years, the contributing partner recognizes the remaining built-in gain or loss as though the partnership had sold the property to that partner.

18. D — Section 736 divides liquidating payments to a retiring or deceased partner into two categories. Section 736(b) payments are treated as a distribution in exchange for the partner's interest in property, generally producing capital gain or loss. Section 736(a) payments, covering amounts not attributable to property, such as unstated goodwill, are taxed as a distributive share or guaranteed payment.

19. B — A joint Section 338(h)(10) election lets the buyer and seller treat a qualifying stock purchase of an S corporation as a deemed sale of the target's assets followed by a liquidation, purely for tax purposes. The target recognizes gain on the deemed asset sale, the buyer receives a stepped-up asset basis, and the transaction legally remains a stock purchase throughout.

20. A — A Type A reorganization is a statutory merger completed under state corporate law and, unlike a Type B (solely voting stock) or Type C (substantially all assets), permits a flexible mix of stock, cash, and other consideration provided continuity of shareholder interest is maintained. A Type F applies only to a single-corporation identity change, not a merger.

21. D — A divisive Type D reorganization occurs when a corporation transfers assets to a controlled corporation in exchange for its stock and then distributes that stock to shareholders under Section 355, as in a spin-off. This differs from an acquisitive Type D, involving a later liquidation, and from Types B, C, or E, none of which describe dividing a corporation's assets.

22. B — A Type E reorganization is a recapitalization involving a single corporation's exchange of one class of its own stock or securities for another, such as preferred for common, with no other corporation or transfer of assets involved. This differs from Type D, an asset transfer between corporations, Type F, an identity change, and Type C, an asset acquisition.

23. A — A Type F reorganization is a mere change in identity, form, or place of organization of a single operating corporation, with no change in shareholders, assets, or business, such as reincorporating in another state. It is distinguished from Type A, a merger of separate corporations, Type D, an asset transfer to a controlled corporation, and Type B, a stock-for-stock acquisition.

24. C — Under Section 1362(f), the IRS may grant relief for an inadvertent termination or invalid election if the corporation shows the termination was inadvertent, takes steps to correct the terminating event within a reasonable time after discovery, and shareholders agree to any adjustments the IRS requires, allowing the S election to be treated as continuing without interruption throughout the entire period.

25. D — Revenue Procedure 2013-30 provides simplified relief for a late S election when the corporation intended to be an S corporation, has reasonable cause for missing the deadline, has filed consistently as an S corporation since the intended effective date, and requests relief within three years and seventy-five days of that date, avoiding the need for a costly private letter ruling.

26. A — Form 2220 is used to compute the addition to tax for underpayment of estimated tax by corporations. A corporation generally avoids the penalty by making timely quarterly installments totaling at least 100% of the current year's tax liability, subject to limited exceptions such as a prior-year safe harbor for certain smaller corporations, rather than simply by extending its filing deadline.

27. B — A corporation meeting both the stock-ownership test, five or fewer individuals owning more than 50% of stock, and the income test, over 60% adjusted ordinary gross income from passive sources, is a personal holding company. If that income is not distributed, a 20% tax applies to undistributed PHC income, separate from the accumulated earnings tax on unrelated retained earnings.

28. C — Where purported debt shows characteristics of equity, such as a high debt-to-equity ratio, repayment contingent on available earnings, subordination to outside creditors, and rough proportionality to stock ownership, the IRS may apply debt-versus-equity factors to recharacterize shareholder advances as equity. This disallows interest deductions to the corporation and reclassifies the payments received by the shareholder as taxable dividends instead.

29. A — An affiliated group meeting the 80% vote-and-value ownership test may elect to file a consolidated federal income tax return. Under the consolidated return regulations, gains and losses on intercompany transactions between group members are generally deferred rather than currently recognized, and are taken into account only when a triggering event, such as the property leaving the consolidated group, later occurs.

30. C — Section 1042 allows a shareholder of a closely held C corporation who sells stock to an ESOP owning at least 30% of the corporation's stock after the sale to elect nonrecognition treatment by reinvesting proceeds in qualified replacement property, typically securities of domestic operating corporations, within the statutory replacement period, deferring the gain rather than excluding or immediately taxing it.

31. D — Section 1244 allows an individual to treat a loss on qualifying small business stock, issued directly by a domestic corporation meeting statutory capitalization and gross-receipts requirements, as an ordinary loss rather than a capital loss, up to $50,000 for a single filer or $100,000 for a joint return, with any excess loss treated as an ordinary capital loss instead.

32. B — Section 1202 allows noncorporate taxpayers to exclude gain on qualified small business stock of a C corporation acquired at original issue and held more than five years. For stock acquired after September 27, 2010, up to 100% of the eligible gain is excludable, limited to the greater of $10 million or ten times the taxpayer's adjusted basis in the stock.

33. D — For an S corporation carrying accumulated earnings and profits from its C corporation years, distributions are traced first through the accumulated adjustments account as a tax-free reduction of stock basis, then any excess is a taxable dividend to the extent of remaining accumulated earnings and profits, with only amounts beyond both layers treated as return of capital or gain.

34. C — Courts and the IRS have generally rejected treating LLC members as automatically exempt limited partners for self-employment tax when a member actively participates in management and daily operations, functioning like a general partner rather than a passive investor. Under this analysis, such a member's distributive share of ordinary business income is generally subject to self-employment tax, not just guaranteed payments.

35. A — In a tax-free reorganization, Section 356 provides that when a shareholder receives boot, such as cash, along with qualifying stock, gain is recognized, but only up to the lesser of the boot received or the shareholder's total realized gain on the exchange. No loss is ever recognized, and the stock portion of the exchange remains fully nontaxable.

36. B — The nonaccrual-experience method under Section 448(d)(5) lets qualifying accrual-basis service providers, in fields like health, law, engineering, or consulting, exclude from accrued income any amounts their own experience shows will likely go uncollected. This differs sharply from the banned reserve method, since income is never accrued in the first place rather than accrued and later written off.

37. C — Under the vacation pay accrual rules, an accrual-method employer may deduct vested vacation pay in the year it vests only if payment is made within two and a half months after year-end. Because this bonus was paid in March, more than 2.5 months after the December 31 vesting date, the deduction shifts entirely to the year of actual payment.

38. A — Section 267(a)(2) requires related-party matching: when an accrual-method payor deducts an expense owed to a related cash-method payee, such as a majority shareholder, the deduction is deferred until the payee actually includes the amount in income. Since the shareholder reports income only upon receipt the following year, the corporation's deduction is likewise deferred to that year.

39. B — Points paid to obtain a loan are treated as prepaid interest. Unlike the special exception for points on a loan secured by a taxpayer's principal residence, points paid for a business loan generally cannot be deducted immediately, even by a cash-method taxpayer; instead, they must be capitalized and deducted ratably as interest expense over the life of the loan.

40. D — The Tax Cuts and Jobs Act suspended the moving expense exclusion and deduction for 2018 through 2025, except for Armed Forces members moving under military orders. Employer reimbursements of a civilian employee's moving costs are therefore fully includible in taxable wages, subject to income and employment tax withholding, though the employer may still deduct the payment as compensation.

41. C — The de minimis safe harbor applies per item, not in the aggregate. A taxpayer without an applicable financial statement may currently deduct amounts up to $2,500 per invoiced item, provided it has a qualifying written accounting policy at the start of the year. Since each unit here cost only $1,800, all 50 items qualify for the deduction.

42. D — The routine maintenance safe harbor permits current deduction of recurring activities, such as inspection, cleaning, testing, and lubrication, that a taxpayer reasonably expects to perform more than once over the property's class life, or more than once during a ten-year period for buildings. Because this maintenance is expected to recur, it need not be capitalized as an improvement.

43. B — The small taxpayer safe harbor lets an eligible taxpayer, with average gross receipts of $10 million or less, currently deduct repair, maintenance, and improvement costs on a building with unadjusted basis of $1 million or less, capped at the lesser of 2% of unadjusted basis or $10,000. Here, 2% of $400,000 is $8,000, so the full $7,500 qualifies.

44. A — Section 195 start-up expenditures cover only costs of investigating or creating a new trade or business the taxpayer is not already engaged in. A taxpayer already operating a business, such as this chain expanding into another city, may generally deduct expansion costs currently as ordinary expenses; only the new entrant's costs must be capitalized and amortized under Section 195.

45. C — The Tax Reform Act of 1986 repealed the reserve method for most taxpayers, requiring the specific charge-off method, under which a bad debt is deducted only when it becomes wholly or partially worthless. Certain small banks and thrift institutions remain a notable statutory exception, still permitted to deduct bad debts using the reserve method rather than the specific charge-off approach.

46. A — The recurring item exception under Section 461(h)(3) lets an accrual-method taxpayer treat a liability as incurred before economic performance occurs, provided the item recurs regularly, is treated consistently, performance occurs within the earlier of 8.5 months after year-end or a reasonable period, and the item is either immaterial or accruing it better matches income and expense.

47. B — The small contractor exception excuses a taxpayer from the percentage-of-completion method for a long-term contract that is expected to be completed within two years of starting and whose average annual gross receipts for the preceding three years fall within the inflation-adjusted threshold. Qualifying contractors may instead use the completed-contract method or another permissible exempt method for that contract.

48. D — Original issue discount is treated as interest that economically accrues over the life of a debt instrument, using a constant-yield method under Section 1272. Both the issuer's interest deduction and the holder's income inclusion generally follow this accrual schedule year by year, regardless of whether either party otherwise reports on the cash or accrual method for its other transactions.

49. B — Section 461(c) permits an accrual-method taxpayer to elect to accrue real property taxes ratably over the period to which the taxes relate, rather than on the date the tax becomes fixed and certain under state or local law. This ratable accrual election smooths deduction timing when a locality's fiscal or lien period does not match the taxpayer's own tax year.

50. D — Under Section 453, gain from a sale of nondealer property where at least one payment is received after the year of sale is automatically reported using the installment method, recognizing a proportionate share of gain as each payment is collected, based on the gross profit ratio, unless the taxpayer elects out and reports the entire gain immediately.

51. A — Under the Alternative Simplified Credit method, the research credit equals 14% of the excess of current-year qualified research expenses over 50% of the average QREs for the three preceding tax years. If the taxpayer had no QREs in any of those three years, a flat 6% rate applies instead. IRC Section 41(c)(5).

52. C — The Section 45F credit combines two components: 25% of qualified childcare facility expenditures and 10% of qualified childcare resource and referral expenditures. It is a component of the general business credit, subject to an overall annual dollar cap, and expenditures used to compute the credit cannot also be deducted as an ordinary business expense.

53. A — Investment credit property, including energy credit property, is subject to a five-year recapture period under Section 50(a). Early disposition or a drop below qualifying business use triggers recapture of a percentage of the credit, decreasing by 20 percentage points for each full year the property was held, so property held four full years recaptures only 20%.

54. C — Percentage depletion is computed as a statutory percentage of gross income from the property and, unlike cost depletion, may continue to be claimed after the property's adjusted basis has been reduced to zero. Cost depletion is limited to the property's remaining adjusted basis, computed by allocating that basis over estimated recoverable units. IRC Sections 611 through 613.

55. B — Cost depletion is computed by dividing the property's adjusted basis ($600,000) by total estimated recoverable units (300,000 tons), yielding a $2 per-unit rate. Multiplying that rate by the 50,000 tons extracted and sold during the year produces a $100,000 cost depletion deduction, which also reduces the property's remaining adjusted basis going forward.

56. D — Section 199A specifically lists health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, and businesses relying on the reputation or skill of an owner or employee as SSTBs. Engineering and architecture were deliberately excluded from this list, so an architecture practice's income qualifies for the full QBI deduction regardless of income level.

57. C — Section 1239 recharacterizes gain on the sale of depreciable property as ordinary income, not capital gain, when the sale occurs between related parties as defined in the statute, including an individual and a corporation more than 50% owned by that individual. This prevents converting capital gain into accelerated future depreciation deductions for the related buyer.

58. B — Unlike the Section 30D consumer clean vehicle credit, the Section 45W commercial clean vehicle credit does not require North American final assembly or battery-component and critical-mineral sourcing thresholds. The credit equals the lesser of 15% (30% for a fully electric, non-plug-in-hybrid vehicle) of the vehicle's basis or its incremental cost over a comparable gasoline vehicle.

59. D — Section 194 allows a taxpayer to immediately deduct up to $10,000 of qualifying reforestation expenditures per qualified timber property each year. Amounts exceeding that limit are not lost; they are instead amortized ratably over an 84-month, or seven-year, period, allowing full cost recovery of reforestation costs over time rather than waiting until harvest.

60. A — To qualify as used property eligible for bonus depreciation, the taxpayer or any predecessor must not have used the property at any time before acquiring it, and the acquisition must be a purchase from an unrelated party in an arm's-length transaction, not received via like-kind exchange, inheritance, or acquisition from a related party. IRC Section 168(k).

61. C — Section 179(d) specifically includes off-the-shelf computer software in the definition of qualifying property eligible for immediate expensing, an exception to the general rule that most intangible property does not qualify. The software must be readily available for purchase by the general public and not substantially modified for Section 179 treatment to apply.

62. D — Section 197 intangibles, including goodwill and going-concern value acquired in connection with a trade or business, are amortized ratably on a straight-line basis over a fixed 15-year period beginning in the month of acquisition, regardless of the asset's actual estimated useful life or any decline in its value over time.

63. B — The Work Opportunity Tax Credit generally equals 40% of qualified first-year wages, capped at $6,000 of wages for most targeted groups, for employees who work at least 400 hours during their first year. Because this employee worked 500 hours, the full 40% rate applies, producing a $2,400 credit, computed as $6,000 times 40%.

64. A — The Section 44 disabled access credit equals 50% of eligible access expenditures exceeding $250, up to a maximum of $10,250 in expenditures, producing a maximum possible credit of $5,000. It is available only to eligible small businesses with gross receipts of $1 million or less, or 30 or fewer full-time employees, in the preceding year.

65. A — The Section 45E credit encourages small employers, generally those with 100 or fewer employees earning at least $5,000 in the prior year, to establish new qualified retirement plans by covering a percentage of eligible startup costs for plan creation, administration, and employee education, subject to an annual dollar cap over the plan's first several years.

66. B — The IRS's online EIN application at IRS.gov is the fastest method: once the responsible party enters the required information and it validates, the system issues the EIN immediately at the end of the session. Paper Form SS-4 remains an option but takes weeks. EINs cannot be transferred between entities, and a business needing employees should obtain one promptly.

67. D — Under Section 6501(b)(2), all Forms 941 filed for a calendar year are deemed filed on April 15 of the following year for statute-of-limitations purposes, even if some were actually filed earlier. This consolidates what would otherwise be four separate quarterly assessment periods into a single three-year clock running from one common date, simplifying IRS assessment timing for employment taxes.

68. C — The Voluntary Classification Settlement Program (Form 8952) lets an eligible business that has been treating workers as nonemployees begin treating them as employees prospectively, paying roughly 10% of one year's employment tax liability under reduced Section 3509 rates, with no interest or penalties and no employment tax audit of those workers for prior years. It requires no current audit.

69. B — Form 940 is normally due January 31 of the following year, but the deadline extends to February 10 for employers who deposited all FUTA tax when due throughout the year. This mirrors the similar extension available for Forms 941 and W-2 when deposits are timely, rewarding compliant depositors with additional filing time rather than an earlier deadline.

70. A — Employers must furnish Form W-2 to each employee by January 31 of the year following the calendar year in which wages were paid, the same date now required for filing copies with the Social Security Administration. This uniform deadline, set by the PATH Act, gives the IRS an earlier opportunity to match reported wages against filed returns and catch fraud.

71. C — COBRA generally entitles a qualified beneficiary who loses coverage due to termination of employment, other than for gross misconduct, or reduced hours to continue the same group health coverage for up to 18 months at their own expense. That period can extend to 29 months if the Social Security Administration determines the beneficiary was disabled at the qualifying event.

72. D — Once an employer's accumulated undeposited employment tax liability reaches $100,000 on any day within a deposit period, the entire amount must be deposited by the next business day regardless of the employer's usual monthly or semiweekly schedule. Triggering this rule also makes the employer a semiweekly depositor for the remainder of the current year and all of the next.

73. C — Sick pay an employee receives from a third party, such as an insurer, generally remains subject to FICA the same as if paid by the employer directly, except that liability ends once six months have passed since the employee last actively worked. Income tax withholding on such payments is voluntary unless the employee requests it using Form W-4S.

74. D — Under Section 280A(c)(1), a home office qualifies as the taxpayer's principal place of business if used exclusively and regularly for administrative or management activities of the business and there is no other fixed location where substantial administrative or management activities occur. This test lets self-employed workers performing services off-site still qualify based on where they manage the business.

75. B — Federal regulations require employers to keep records relevant to employment taxes, including wage payment dates, amounts, and deposit records, for at least four years after the date the tax becomes due or is actually paid, whichever is later. This retention period is longer than the general three-year assessment period for income tax returns since some employment tax issues surface later.

76. A — Employers may withhold federal income tax from supplemental wages, such as a bonus paid separately from regular wages, at an optional flat rate of 22 percent, provided the employee's supplemental wages for the year do not exceed $1 million and regular wages were subject to withholding. Amounts above that threshold must instead be withheld at the mandatory 37 percent rate.

77. D — Wages a parent pays to a child under age 18 employed in the parent's sole proprietorship, or a partnership of only the child's parents, are exempt from Social Security and Medicare tax, and exempt from FUTA until the child turns 21. This exception does not apply once the business operates as a corporation, a separate legal entity from the parent.

78. B — A successor employer acquiring substantially all of a predecessor's business property and continuing to employ the same workers may treat wages the predecessor paid those employees that year as paid by the successor for wage-base purposes. This lets the successor credit prior wages toward the Social Security and FUTA wage bases, avoiding duplicate tax on wages already at the limit.

79. A — Virtually all federal tax deposits, including payroll tax deposits, must be made electronically through the Electronic Federal Tax Payment System (EFTPS), which employers can enroll in free of charge. Paper coupon deposits using the old Form 8109 were phased out years ago. Very small quarterly liabilities under $2,500 may instead be remitted directly with the related return rather than deposited.

80. C — A QPRT lets a grantor transfer a personal residence to an irrevocable trust while retaining the right to live there for a set term. If the grantor survives the term, the home passes to remainder beneficiaries outside the taxable estate, and the taxable gift is valued using the discounted present value of the remainder interest, not full fair market value.

81. A — A GRAT lets a grantor transfer appreciating assets to an irrevocable trust while receiving a fixed annuity for a set term, with the taxable gift valued near zero if the annuity equals the trust's initial value. Growth exceeding the Section 7520 hurdle rate passes to remainder beneficiaries transfer-tax-free, making a 'zeroed-out' GRAT an effective way to shift appreciation.

82. C — Because an intentionally defective grantor trust is disregarded for income tax purposes, a sale between the grantor and the trust is treated as a transaction with oneself, producing no recognized gain, loss, or taxable interest income. The asset and its appreciation are removed from the grantor's estate while the grantor keeps paying the trust's income tax.

83. B — Section 2032A allows an estate to value qualifying farm or closely held business real property based on its actual use rather than its highest and best use, reducing estate tax exposure. The reduction is capped at a statutory, inflation-adjusted dollar limit. A qualified heir must continue the qualified use for at least ten years, or recapture tax applies.

84. D — A deductible qualified conservation contribution requires a donation of a qualified real property interest, such as a perpetual restriction on land use, to a qualified organization exclusively for conservation purposes such as preserving open space, wildlife habitat, or historic land. The restriction must be permanent; a temporary or revocable easement does not support a charitable deduction under Section 170(h).

85. A — Under Section 453(e), when a taxpayer sells property on the installment method to a related party who resells it within two years, the original seller must generally treat the resale proceeds as received, accelerating recognition of the remaining deferred gain. This anti-abuse rule prevents related parties from using installment sales to convert deferred gain into immediate cash without triggering tax.

86. B — Under the passive activity grouping regulations, a taxpayer may treat multiple trade or business undertakings as a single activity for material participation and passive loss purposes if they form an appropriate economic unit, based on facts such as similarities in business type, common control, common ownership, geographic location, and interdependence between the undertakings, rather than testing each in isolation.

87. D — One of the seven regulatory tests for material participation is met when the individual participates in the activity for more than 500 hours during the tax year, regardless of whether that participation exceeds anyone else's. Meeting any single test is sufficient to treat the activity as nonpassive, allowing losses to offset other income without the passive activity loss limitation applying.

88. C — Under the self-rental rule, net rental income from property leased to a business in which the taxpayer materially participates is recharacterized as nonpassive income, even though rental activities are generally passive by definition. This prevents taxpayers from generating passive income on paper solely to absorb suspended passive losses from unrelated activities. Losses from such self-rentals, however, generally remain passive.

89. B — Qualified plan loans are generally limited to the lesser of $50,000 or 50% of the participant's vested accrued benefit. With a $120,000 vested balance, 50% would be $60,000, but the $50,000 statutory cap controls, so $50,000 is the maximum available loan. Loans must generally be repaid within five years unless used to purchase a principal residence.

90. D — Under current law, required minimum distributions must generally begin by age 73, and the required beginning date for the first distribution is April 1 of the year following the year the account owner turns 73. Delaying the first distribution to that date means two distributions, the first and second year's amounts, must both be taken within the same calendar year.

91. C — Church plans are generally exempt from ERISA's Title I requirements, including participation, vesting, funding, and fiduciary standards, reflecting concerns about government entanglement with religious organizations. A church plan may nonetheless make an irrevocable election to be subject to ERISA. Absent that election, the plan can still qualify for tax purposes under Section 401(a) while avoiding ERISA's compliance burdens.

92. A — Rental income from real property is normally excluded from unrelated business taxable income, but the exclusion does not apply to debt-financed property. Under the UDFI rules, a percentage equal to average acquisition indebtedness divided by the property's average basis is treated as taxable unrelated business income, even though renting real estate is not itself an active trade or business.

93. D — Supporting organizations are classified by their relationship to the organizations they support. Type I is operated, supervised, or controlled by the supported organization, resembling a parent-subsidiary link. Type II is supervised or controlled in connection with it, reflecting common control. Type III is merely operated in connection with the supported organization and faces the strictest responsiveness requirements.

94. A — Portability allows a surviving spouse to use a deceased spouse's unused applicable exclusion amount, known as the DSUE, but the election is not automatic. The decedent's executor must timely file a complete and properly prepared Form 706, even if the estate owes no estate tax, and affirmatively elect portability on that return, or the unused exclusion is permanently lost.

95. C — Nongrantor trusts reach the highest marginal income tax rate at a very low level of taxable income compared to individuals. Because trust income taxed to beneficiaries is generally taxed at their own, often lower, individual rates, trustees frequently distribute income currently rather than accumulate it, using the distribution deduction to shift income out of the compressed trust brackets.

96. B — For trusts, the 3.8% net investment income tax applies to the lesser of undistributed net investment income or the excess of adjusted gross income over the dollar amount at which the trust reaches its highest income tax bracket, a low threshold. This compressed threshold, combined with compressed ordinary rates, makes accumulating investment income inside a trust costly compared to individuals.

97. C — A qualified charitable distribution lets an IRA owner at least 70½ transfer funds directly from the IRA to a qualified charity, excluding the amount from gross income and counting it toward the year's required minimum distribution, up to an annually indexed limit. Unlike an itemized deduction, a QCD reduces income even for taxpayers using the standard deduction.

98. A — Section 4943 generally limits a private foundation's combined holdings, together with those of disqualified persons, to 20% of a business enterprise's voting stock, with certain exceptions such as a de minimis 2% rule. Holdings above that limit are excess business holdings, subject to an initial excise tax and, if not timely divested, an additional tax on the foundation.

99. D — Fiduciary accounting income is determined under the terms of the trust instrument and applicable state principal-and-income law, governing what the trustee may distribute to income beneficiaries, such as excluding most capital gains, which are usually allocated to principal.

Distributable net income and taxable income are instead federal tax concepts computed under the Internal Revenue Code for reporting purposes.

100. B — The farm optional method on Schedule SE lets a farmer with low or no net profit report a set percentage of gross farm income, subject to a dollar cap, as self-employment earnings instead of actual net earnings. This can preserve Social Security and Medicare earnings credit and safeguard future benefit eligibility in years when actual farm profit is minimal.