PRACTICE EXAM 18: 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 single partnership divides into two separate partnerships, with the original partnership contributing certain assets and liabilities to a newly formed partnership under the assets-over form, then distributing the new entity's interests to some partners. Under the general rule for identifying a divided partnership's continuation, which resulting partnership is treated as the continuation of the prior partnership?

A. Whichever resulting partnership was formed later in time, regardless of ownership continuity among the partners
B. Both resulting partnerships are automatically treated as terminating, with neither continuing the prior partnership's tax attributes
C. The resulting partnership whose partners owned more than 50% of the interests in the capital and profits of the prior partnership
D. The resulting partnership holding the greater dollar amount of tax basis in assets, regardless of the partners' ownership percentages

2. Two partnerships agree to combine, but instead of using the default assets-over structure, the terminating partnership actually distributes its assets and liabilities directly to its own partners, who then contribute those assets and liabilities to the surviving partnership in exchange for interests. Which form of partnership merger does this describe?

A. The assets-over form, which is the default treatment applied automatically whenever two partnerships merge under state law

B. The assets-up form, an alternative structure requiring an actual distribution to the terminating partnership's partners before their contribution to the survivor

C. A partnership division, since assets are being separated from the terminating partnership before any transfer occurs between entities

D. A taxable liquidation, since any transfer of assets directly to partners is treated as a complete sale for cash

3. A partnership has nonrecourse debt secured by partnership property, and no partner bears personal liability for repayment. Under the Section 752 regulations governing nonrecourse liability allocation among partners' outside bases, what is the correct order in which the three tiers are applied?

A. Partnership minimum gain first, then built-in gain under Section 704(c) minimum gain, then the partners' profit-sharing ratios

B. Profit-sharing ratios first, then partnership minimum gain, then built-in gain under Section 704(c) minimum gain last

C. Built-in gain under Section 704(c) minimum gain first, then profit-sharing ratios, then partnership minimum gain applied last

D. All three tiers are applied simultaneously in equal proportion, with no fixed sequential order among the three tiers

4. A publicly traded partnership generates at least 90% of its gross income from qualifying passive-type sources such as interest, dividends, real property rents, and income from natural resource activities. Under the Section 7704(c) qualifying income exception, how is this partnership treated for federal income tax purposes?

A. It must convert to S corporation status immediately, since publicly traded entities cannot remain partnerships under any exception

B. It is automatically taxed as a REIT rather than as a partnership, regardless of its actual organizational structure

C. It loses partnership status permanently once its interests begin trading on an established securities market, with no exceptions

D. It continues to be taxed as a partnership rather than as a corporation, despite being publicly traded on an established market

5. Midway through the partnership's tax year, an incoming partner purchases half of an existing partner's 40% interest, so ownership percentages differ before and after the sale. Under the varying interest rule of Section 706(d), how must the partnership generally account for this change when allocating that year's items among the partners?

A. The full-year items must be allocated entirely to whichever partner held the largest interest as of the last day of the tax year

B. The partnership must instead terminate for tax purposes and file two short-period returns splitting the year at the sale date

C. The partnership must generally use an interim closing of the books or a proration method to allocate items based on each partner's varying interest during the year

D. No adjustment is required; year-end ownership percentages alone control the allocation of every item for the entire tax year

6. A partner formally abandons her partnership interest by affirmative written notice to the other partners, receiving no consideration in return. At the time of abandonment, she is not relieved of any share of partnership liabilities. How is her resulting loss generally characterized?

A. The loss is disallowed entirely, since abandoning a partnership interest without a buyer is never a recognized taxable event

B. The loss is ordinary under Section 165, because no sale or exchange occurs when no liabilities are shifted away from her

C. The loss is automatically treated as a capital loss identical to a sale, since abandonment always mirrors a taxable exchange

D. The loss must be capitalized into the basis of her remaining investment assets rather than deducted in the current year

7. A partner who owns 60% of the capital and profits interests in a partnership sells depreciable equipment to the partnership at a loss. Under Section 707(b), how is this loss generally treated?

A. The loss is entirely disallowed, because the partner and partnership are related parties under the more-than-50% ownership threshold

B. The loss is fully allowed as an ordinary business loss, since the transaction involves depreciable property used in a trade

C. Only 50% of the loss is disallowed, with the remaining half deductible immediately against the partner's other ordinary income

D. The loss is allowed currently but must be recaptured as ordinary income if the partnership later resells the property at a gain

8. A partnership is forming and must determine its required taxable year under Section 706(b). Partners owning more than 50% of both capital and profits interests all use the same calendar taxable year. Under the primary test for determining a partnership's required year, what taxable year must the partnership adopt?

A. The partnership may freely choose any fiscal year it prefers, since the majority-interest test is only advisory guidance

B. The taxable year used by the single largest individual partner, regardless of what the majority collectively uses instead

C. The calendar year used by the partners who together own a majority interest, since that is the required taxable year

D. A fiscal year ending one month before the majority partners' taxable year, to allow adequate time for return preparation

9. A partnership makes a liquidating cash distribution to a departing partner in excess of her outside basis, causing her to recognize gain. The partnership has a valid Section 754 election in effect. Under Section 734(b), what happens to the basis of the partnership's remaining property?

A. Nothing changes, because Section 734(b) only applies to distributions of property, never to distributions consisting solely of cash

B. The remaining partners must each personally recognize the same gain the departing partner recognized on her cash distribution

C. The partnership must reduce the basis of its remaining cash equivalents by the exact dollar amount the partner received

D. The partnership increases the basis of its remaining property by an amount equal to the gain recognized by the distributee partner

10. A partner's distributive share of partnership ordinary loss for the year is $50,000, but her outside basis in the partnership immediately before the loss allocation is only $30,000. Under Section 704(d), how is this loss treated on her individual return?

A. She may deduct only $30,000 in the current year, with the remaining $20,000 suspended and carried forward indefinitely until basis is restored
B. She may deduct the entire $50,000 currently, since Section 704(d) applies only to distributions and never limits loss deductions directly
C. The excess $20,000 is permanently disallowed and may never be deducted, even if her outside basis later increases in a future year
D. She must amend the partnership agreement retroactively to reallocate the excess loss to partners who have sufficient outside basis available

11. A sole proprietor has net profit of $40,000 from her business for the year, her only self-employment income. Before applying the self-employment tax rate, what amount is treated as her net earnings from self-employment, and is she required to file Schedule SE?

A. $40,000 exactly, with no filing requirement because net earnings never require a separate self-employment tax schedule to be filed
B. $30,000, calculated by reducing net profit by a flat 25% adjustment before any self-employment tax rate is ever applied
C. $40,000, but she is exempt from filing Schedule SE because her net profit falls below $50,000 for the year
D. $36,940, calculated by multiplying net profit by 92.35%, and she must file Schedule SE because it exceeds the $400 threshold

12. A partnership distributes only cash to one partner while retaining substantially appreciated inventory, shifting that partner's share of the hot assets to the remaining partners in the process. Under Section 751(b), what is the tax consequence of this disproportionate distribution?

A. No consequence results, because Section 751(b) applies exclusively to sales of partnership interests rather than to partnership distributions

B. The distribution is treated in part as a taxable exchange, requiring the distributee partner to recognize ordinary income on the shifted hot-asset value

C. The entire distribution is automatically recharacterized as a liquidating distribution regardless of the partner's remaining interest in the partnership

D. The remaining partners must immediately sell the retained inventory to a third party before any distribution can be treated as valid

13. An individual sole proprietor owns several residential rental properties and is not a real estate dealer; she merely collects rent and pays expenses without providing substantial services to tenants. How is this rental income generally treated for self-employment tax purposes under Section 1402?

A. All rental income is automatically subject to self-employment tax whenever the owner reports it as business income on Schedule C

B. Rental income is subject to self-employment tax only if the properties are held for fewer than five consecutive years

C. Rental income from real estate is generally excluded from net earnings from self-employment, absent dealer status or substantial services

D. Rental income becomes subject to self-employment tax automatically once the owner holds more than two rental properties simultaneously

14. A partnership operates on a calendar tax year, but one of its partners uses a fiscal year ending June 30. The partnership accrues a guaranteed payment for services to that partner in December of the current year. Under Section 707(c), in which tax year must the partner generally include this guaranteed payment in income?

A. In the partner's tax year within which the partnership's tax year ends, regardless of the partner's own differing fiscal year

B. In the partner's own fiscal year in which the payment is actually received in cash by the partner

C. Ratably split between the partnership's and the partner's overlapping fiscal periods based on the number of months in each

D. In the calendar year following the year the partnership actually deducts the guaranteed payment on its return

15. A partner also owns a building outside the partnership and leases that building to the partnership at a fair rental rate, in a transaction unrelated to her capacity as a partner. Under Section 707(a)(1), how is this rental arrangement generally treated for tax purposes?

A. The rent is automatically recharacterized as a guaranteed payment for capital, since any transaction with a partner is treated as a partnership item

B. The transaction is treated as if it occurred between the partnership and an unrelated outside party, since she is acting in a nonpartner capacity

C. The rent must be reported as an item of the partnership's ordinary business income rather than as separate rental income to her

D. The arrangement is disregarded entirely for tax purposes, since a partner cannot legally engage in transactions with her own partnership

16. A partnership has no group of partners owning a majority interest who share the same taxable year, so the majority interest taxable year test under Section 706(b) does not resolve the partnership's required year. Which method is applied next to determine the required taxable year?

A. The partnership defaults automatically to a fiscal year ending June 30, regardless of any partner's individual taxable year

B. The IRS assigns a taxable year at random among the distinct years used by the partnership's various partners

C. The partnership permanently loses its ability to use any taxable year other than the calendar year going forward

D. The least aggregate deferral method is applied, selecting the taxable year that produces the smallest total deferral of income across all partners

17. An individual sells her entire sole proprietorship business for a single lump-sum price, with the buyer acquiring inventory, equipment, and goodwill together. For federal income tax purposes, under the aggregate theory established in Williams v. McGowan, how is this transaction treated?

A. As the sale of a single capital asset, taxed entirely at long-term capital gain rates regardless of the underlying asset types

B. As a single ordinary income transaction, since a sole proprietorship has no separate legal existence apart from its individual owner

C. As a sale of each underlying asset separately, with gain or loss on each asset characterized under its own applicable tax rules

D. As a tax-free reorganization, provided the buyer continues operating the business under the same trade name for at least one year

18. A self-employed individual expects to owe substantially more tax this year than last year because of strong self-employment income. Her prior year adjusted gross income exceeded $150,000. To avoid an underpayment penalty using the prior-year safe harbor, what percentage of her prior-year tax liability must her timely estimated payments generally equal?

A. 100% of her prior-year tax liability, the same flat percentage that applies regardless of her prior-year income level

B. 90% of her prior-year tax liability, with no distinction made for taxpayers whose prior-year income exceeded any threshold

C. 75% of her current-year projected tax liability, calculated using annualized income installments exclusively for high-income taxpayers

D. 110% of her prior-year tax liability, the higher safe harbor percentage that applies to higher-income taxpayers

19. Individual Owens owns all the stock of both Corporation M and Corporation N, brother-sister corporations with no parent-subsidiary relationship between them. Owens sells stock of Corporation M to Corporation N for cash, and immediately after the sale Owens still controls both corporations. Under IRC Section 304(a)(1), how is this stock sale generally treated for tax purposes?

A. As a distribution in redemption of Corporation N's stock, tested under Section 302 for dividend versus sale treatment

B. As a straightforward taxable sale of stock between two unrelated corporations, with no distribution treatment

C. As a tax-free contribution of stock to Corporation N's capital, with no gain recognized at all

D. As a deemed liquidation of Corporation M into Corporation N, taxed under the liquidation rules

20. A corporation distributes preferred stock as a tax-free stock dividend to its common shareholders, and the preferred stock qualifies as 'Section 306 stock.' Several years later, a shareholder sells this preferred stock to an unrelated buyer at a gain. How is the gain on this sale generally treated?

A. As long-term capital gain, since the preferred stock was held for more than one year
B. As ordinary income up to the stock's ratable share of earnings and profits at distribution
C. As a tax-free return of capital, since the stock was originally received as a dividend
D. As a Section 1231 gain, because the stock is treated as property used in the business

21. Distributing Corp has operated a manufacturing business for the past six years and, three months ago, purchased a wholly new retail business it never previously operated. Distributing Corp now wants to spin off the retail business to its shareholders in a transaction intended to qualify under Section 355. Why would this spin-off likely fail the active trade or business requirement?

A. The retail business has not been actively conducted by Distributing Corp for the required five-year period
B. Section 355 spin-offs are never permitted when the distributed business differs from the retained business
C. The retail business must instead be sold for cash before any spin-off can be considered tax-free
D. Distributing Corp must own at least 80% of the retail business's voting stock before distributing it

22. A shareholder's stock in a corporation becomes completely worthless during the year. The stock does not meet the requirements of Section 1244 small business stock. Absent that special provision, how is the shareholder's loss on the worthless stock generally treated under Section 165(g)?

A. As an ordinary loss, fully deductible against the shareholder's other income for the year
B. As a nondeductible personal loss, since worthless stock produces no tax benefit whatsoever
C. As a capital loss, deemed a sale or exchange occurring on the last day of the year
D. As a casualty loss, subject to the personal casualty loss limitations that generally apply

23. A calendar-year C corporation has a net capital loss for the current tax year that it cannot use because it has no capital gains against which to offset it. Under the general rule for corporate capital losses, how may this net capital loss be carried to other tax years?

A. Carried forward indefinitely, similar to the treatment of net operating losses under current law
B. Carried back 5 years and forward 3 years, offsetting both capital and ordinary income

C. Carried back 1 year only, with no forward carryover permitted for corporations at all

D. Carried back 3 years and forward 5 years, offsetting capital gains in those years only

24. Corporation A owns 45% of the stock of Corporation B, an unrelated domestic taxable corporation, and receives a $20,000 dividend from Corporation B during the year. This ownership falls within the 20%-but-less-than-80% tier for dividends-received deduction purposes. What percentage of the dividend may Corporation A generally deduct?

A. 50%, the rate applying to corporations owning less than 20% of the payor corporation

B. 65%, the rate applying to corporations owning at least 20% but less than 80%

C. 80%, the rate applying to corporations owning a majority but less than full control

D. 100%, the rate applying only to members of the same affiliated group of corporations

25. A group of individuals wants to form a corporation and immediately elect S status. Which of the following entities is specifically ineligible to make an S election under IRC Section 1361, regardless of otherwise meeting the shareholder and stock requirements?

A. A restaurant corporation with 60 shareholders, all of whom are United States citizens

B. A retail corporation that is wholly owned by a single individual shareholder

C. A domestic corporation that has only one class of outstanding stock issued

D. An insurance company that is subject to tax under the rules of subchapter L

26. A corporation distributes substantially all of its assets to its sole shareholder in liquidation while a federal tax liability from an earlier year remains unpaid and uncollected. The IRS is unable to collect the tax from the now-defunct corporation. Under transferee liability principles, what may the IRS generally do?

A. Pursue the shareholder personally for the unpaid corporate tax, up to the value of assets received

B. Take no further collection action, since corporate liabilities are extinguished automatically upon dissolution

C. Assess the unpaid tax against the corporation's former officers personally without any limitation at all

D. Refer the matter exclusively to state court for a wrongful distribution claim instead

27. Parent Corp owns all the stock of Subsidiary Corp. A shareholder who controls Parent Corp sells stock of Parent Corp to Subsidiary Corp for cash. Under IRC Section 304(a)(2), which governs this parent-subsidiary acquisition as distinguished from the brother-sister rule of Section 304(a)(1), how is the transaction treated?

A. As a tax-free contribution to Subsidiary Corp's capital, since the entities are commonly controlled
B. As a distribution in redemption of Parent Corp's own stock, tested under Section 302
C. As an ordinary sale of stock generating capital gain with no distribution recharacterization applied
D. As a deemed dividend paid directly from Subsidiary Corp's earnings with no redemption analysis

28. Parent Corp owns 90% of the stock of Subsidiary Corp by both vote and value. Subsidiary Corp completely liquidates and distributes all of its assets to Parent Corp in cancellation of Parent Corp's stock. Assuming the requirements of Section 332 are met, how does Parent Corp generally treat this liquidating distribution?

A. Parent Corp recognizes gain to the extent the assets' fair market value exceeds its stock basis
B. Parent Corp must report the distribution entirely as ordinary dividend income at fair market value
C. Parent Corp generally recognizes no gain or loss, and takes a carryover basis in the assets
D. Parent Corp recognizes a capital loss equal to any excess of stock basis over assets received

29. A loss corporation with substantial net operating loss carryforwards undergoes an ownership change in which more than 50 percentage points of its stock ownership shifts among certain shareholders within a three-year testing period. Under IRC Section 382, what is the general effect on the corporation's ability to use its pre-change NOLs?

A. Use of the pre-change NOLs against future income is limited to an annual amount tied to value
B. The pre-change NOLs are entirely and permanently forfeited upon any ownership change at all
C. The ownership change has no effect, since NOL carryforwards are never limited by stock transfers
D. The pre-change NOLs may be used only against income from an entirely new trade or business

30. A profitable corporation acquires control of a corporation with large unused net operating loss carryforwards, and the principal purpose of the acquisition is to secure those losses to offset the acquirer's future income, with no meaningful business purpose. Under IRC Section 269, what authority does the IRS have here?

A. The IRS must respect the acquisition and allow full use of the acquired losses
B. The IRS may only impose a penalty tax without affecting the losses themselves
C. The IRS may disallow the deduction, credit, or allowance obtained through the tax-avoidance acquisition
D. The IRS may tax the acquisition as a personal holding company regardless of income type

31. An S corporation shareholder's stock basis was previously reduced to zero by passed-through losses, and her remaining basis in a direct loan she made to the corporation was also reduced by additional losses in a prior year. This year, the corporation has net income to allocate to her. Under the general ordering rules, how is this income first applied?

A. It is applied first to restore the shareholder's stock basis before any debt basis restoration
B. It is applied equally between stock basis and debt basis regardless of which was reduced first
C. It has no effect on either basis, since income allocations never restore previously reduced basis
D. It is applied first to restore the previously reduced debt basis, before increasing stock basis

32. A creditor of an individual LLC member, unrelated to any debt of the LLC itself, obtains a judgment against that member personally. Under most state LLC statutes, what is the creditor's primary remedy against the debtor-member's interest in the LLC?

A. The creditor may seize and liquidate the LLC's underlying business assets directly
B. The creditor is generally limited to a charging order against the member's distributional interest
C. The creditor automatically becomes a substitute member with full voting and management rights
D. The creditor may force a judicial dissolution of the LLC to satisfy the judgment

33. A parent S corporation owns 100% of a subsidiary corporation and makes a valid Qualified Subchapter S Subsidiary (QSub) election for that subsidiary. For federal income tax purposes, what is the general effect of making this QSub election?

A. The subsidiary continues to file its own separate corporate income tax return each year
B. The subsidiary is treated as a newly formed C corporation as of the election date
C. The subsidiary is treated as if liquidated into the parent, becoming a disregarded entity
D. The subsidiary must independently satisfy every S corporation eligibility requirement on its own

34. A shareholder who owns 70% of a corporation's outstanding stock sells land held for investment to that corporation at a loss. Under IRC Section 267(a)(1), how is this loss generally treated because of the parties' relationship?

A. Fully deductible, since Section 267 applies only to future related-party gain transactions
B. Disallowed entirely, because losses on sales or exchanges between related parties are not deductible
C. Deductible only to the extent the corporation later resells the land at a gain
D. Deductible in full, but only if the sale price reflects fair market value

35. A calendar-year corporation wants to elect S status effective January 1 of the current year, but one shareholder sold all of her stock and left the corporation on January 20 of that same year, before the election was filed. Whose consent is required on Form 2553 for the election to be valid?

A. Every shareholder who owned stock at any time before the election is filed during the year
B. Only shareholders who remain owners on the date Form 2553 is actually filed
C. Only the corporation's officers and directors, since shareholder consent is not required at all
D. Only shareholders owning at least two-thirds of the outstanding shares on the filing date

36. A business operates two distinct segments: a retail product line requiring inventory and a separate service line with no inventory. The owner wants to use the accrual method for the inventory-related purchases and sales while using the cash method for the service segment's income and expenses. Under the regulations governing accounting methods, is this combination generally permitted?

A. No, because the Code requires every trade or business, regardless of structure, to adopt one single accounting method
B. Only if the business first obtains a private letter ruling specifically authorizing the combined methods
C. No, because any inventory anywhere in the business automatically forces the entire business onto the accrual method

D. Yes, a hybrid method combining cash and accrual for distinct, separately accounted segments is permitted if it clearly reflects income

37. An accrual-method business disputes a $25,000 assessment from a state regulatory agency but transfers $25,000 into escrow to provide for satisfaction of the liability while continuing to litigate the dispute in court. The transfer meets the requirements for this alternative to actual payment. Under IRC Section 461(f), when may the business deduct the contested amount?

A. In the year the money or property is transferred to provide for satisfaction of the contested liability, despite the ongoing contest

B. Only in the year the contest is finally resolved by settlement, judgment, or agency ruling

C. Ratably over the number of years the contest remains actively pending before the courts

D. Never, because contested liabilities remain permanently nondeductible until the taxpayer abandons the contest entirely

38. A business pays a real estate broker a $9,000 commission to help negotiate and acquire a ten-year commercial lease for its retail space. How must the business generally treat this commission for federal income tax purposes?

A. Deducted in full in the year paid, as an ordinary and necessary business expense

B. Capitalized and amortized ratably over the term of the lease being acquired

C. Deducted immediately in full under the twelve-month rule for prepaid expenses

D. Added permanently to the depreciable basis of the landlord's underlying real property

39. A corporation elects to use the LIFO method for valuing inventory on its federal income tax return. Under the LIFO conformity requirement, what restriction does this election generally place on the corporation's financial reporting?

A. The corporation must switch to FIFO for financial statement purposes within three years of electing LIFO

B. The corporation may report inventory under any method to shareholders as long as taxable income reconciles

C. The corporation generally cannot report inventory under a non-LIFO method in financial statements issued to shareholders or for credit purposes

D. The corporation must obtain shareholder approval before continuing to use LIFO in any future tax year

40. A C corporation that is not a qualified personal service corporation or a tax shelter has average annual gross receipts of $34 million for the three-tax-year period ending with the prior year, exceeding the inflation-adjusted Section 448 threshold. The corporation has been using the cash method. What is it generally required to do?

A. Continue using the cash method indefinitely, since the gross receipts threshold applies only to S corporations

B. Adopt the completed-contract method for all future transactions in place of its current method

C. Adopt a permanent hybrid method combining cash and accrual for all future tax years

D. Switch to the accrual method for federal tax purposes, generally by filing Form 3115 to request the change

41. A retailer holds inventory that has become obsolete and unsalable at normal prices because of shifting consumer trends, and the goods can now be sold only at reduced prices well below their usual selling price. Under the regulations governing inventory valuation, how may the retailer generally treat this obsolete inventory?

A. The inventory must remain valued at full cost until it is physically discarded or destroyed

B. The inventory may be written down only after being donated to a qualified charitable organization

C. The inventory may be written down only if the retailer exclusively uses the LIFO method

D. The inventory may generally be written down to its bona fide selling price, a recognized departure from cost for subnormal goods

42. A business is constructing a warehouse for its own use, with total project costs of $2,000,000, funding $600,000 from its own cash and the remainder from general corporate borrowing not specifically traced to the construction project. Under the avoided-cost method of Section 263A(f), how must interest on this general debt generally be treated?

A. It is fully deductible currently, because the general debt was never directly traced to the construction project itself

B. It is entirely ignored for capitalization purposes, since only loans directly traced to a specific project require capitalization

C. Interest is capitalized using the rate the business would have avoided paying on that debt, applied to the excess construction expenditures

D. It is currently deducted in full, then recaptured as ordinary income once the completed warehouse is eventually sold

43. A wholesale distributor subject to the uniform capitalization rules maintains a purchasing department responsible for negotiating and placing all inventory purchase orders. Under Section 263A, how must the distributor generally treat the operating costs of this purchasing department?

A. Capitalized as an additional Section 263A cost properly allocable to the inventory the department acquires

B. Deducted currently in full, because purchasing costs are administrative rather than production-related costs

C. Deducted currently, but only if the distributor uses the cash method of accounting

D. Capitalized only if the purchasing department also performs the distributor's marketing functions

44. A contractor enters into a long-term construction contract with a total contract price of $1,000,000 and estimated total costs of $800,000. By the end of the current year, the contractor has incurred $200,000 of allocable contract costs. Under the percentage-of-completion method, what amount of gross contract income must the contractor recognize for the current year?

A. $200,000, equal to the total costs actually incurred by the contractor during the year

B. $50,000, based on the percentage of estimated costs incurred applied to total expected gross profit

C. $25,000, computed by dividing costs incurred by the total contract price

D. $250,000, computed as twenty-five percent of the total contract price alone

45. A contractor using the percentage-of-completion method completes a long-term contract and determines that the income actually recognized in each prior year differed from what would have been reported had the final total contract price and total costs been known in advance. Under the look-back method of Section 460, what is generally required upon completion?

A. The contractor must amend and refile every original return filed during the contract's duration

B. The contractor must switch retroactively to the completed-contract method for the entire finished contract

C. No look-back adjustment is required once the percentage-of-completion method has been used for reporting

D. The contractor recomputes each prior year's tax using hypothetical reallocated income, paying or receiving interest on the difference

46. A homebuilder constructs single-family homes for sale to individual buyers, and at least 80% of the estimated total costs on each contract relate to dwelling units in buildings of four or fewer units. Under the home construction contract exception, which accounting method may the homebuilder use for these contracts, regardless of contract duration or the homebuilder's gross receipts?

A. Only the percentage-of-completion method, exactly as required for other long-term construction contracts

B. Only the cash method, since inventory accounting rules never apply to residential construction

C. The completed-contract method or another permissible exempt method, without regard to the small contractor gross receipts test

D. The mark-to-market method, requiring each home to be revalued as inventory every year

47. A business received and reported $80,000 of income in a prior year under a claim of right and paid tax on the full amount. In the current year, the business must repay $80,000 of that amount because it did not, after all, have an unrestricted right to keep it. How does the business generally treat this repayment?

A. The repayment is disregarded entirely, since the income was properly taxed in the year received

B. The business generally deducts the repayment currently, or if more favorable, recomputes the prior year's tax under Section 1341

C. The business must amend the original prior-year return to remove the previously reported income

D. The repayment is treated as a nondeductible capital contribution made to the original payee

48. A graphic designer exchanges design services with a plumber, who repairs the designer's office plumbing in return, with no cash changing hands between the two businesses. The fair market value of each party's services is $1,200. How must each business generally treat this bartering transaction for federal tax purposes?

A. Each business includes $1,200 of gross income, the fair market value of services received, deducting the value provided if otherwise deductible
B. Neither business recognizes any income, because no cash actually changed hands in the exchange
C. Only the plumber recognizes income, since plumbing repairs are treated as a taxable service
D. Each business recognizes income only once the services received are later resold to a third party

49. An individual sells business real property to her adult son in an installment sale, reporting gain under the installment method. Within two years of the original sale, the son resells the property to an unrelated buyer for cash, before the individual has collected all of the original installment payments. Under the related-party installment sale rules of Section 453(e), what is the general effect of the son's resale?

A. The resale by the son has no effect on how the original seller reports her gain
B. The amount realized by the son is treated as received by the original seller, accelerating her deferred gain
C. The original seller's remaining gain becomes permanently exempt once the property leaves the family
D. The son becomes personally liable for the original seller's entire remaining deferred tax liability

50. A corporation engaged in the trade or business of farming is not an S corporation and does not qualify for the family farming corporation exception. Under IRC Section 447, what accounting method must this corporation generally use for its farming operations?

A. The accrual method, subject to narrow exceptions for family farming corporations and certain small farming corporations
B. The cash method, without limitation, because farming income receives specialized treatment under the Code
C. The completed-contract method, since growing crops are treated the same as long-term construction contracts
D. Whichever method the corporation's shareholders select annually by unanimous written consent filed with its return

51. A calendar-year taxpayer places nonresidential real property in service on March 10. Under MACRS, which depreciation convention applies to this property, and how is the property treated for purposes of computing the first-year depreciation deduction?

A. The half-year convention applies, treating the property as placed in service at the midpoint of the tax year regardless of the actual date.
B. The mid-quarter convention applies, treating the property as placed in service at the midpoint of the quarter in which it was actually placed in service.
C. The mid-month convention applies, treating the property as placed in service at the midpoint of the month in which it was actually placed in service.
D. No convention applies, and depreciation is instead computed using the exact number of days the property was in service that year.

52. A taxpayer expensed $30,000 of equipment under Section 179 in the year it was placed in service, when business use was 80%. In the following year, business use of the same equipment drops to 45%. What is the tax consequence?

A. No recapture is required because Section 179 recapture applies only when property is fully disposed of, not when business use merely declines.
B. The taxpayer must switch to bonus depreciation on the remaining basis but reports no income from the change in business use.
C. The taxpayer may claim an additional Section 179 deduction this year to offset the reduced business-use percentage of the equipment.
D. The taxpayer must recapture as ordinary income the excess of the Section 179 deduction claimed over the depreciation allowable absent the election.

53. An investor rehabilitates a certified historic structure used in a trade or business, incurring qualified rehabilitation expenditures. How is the resulting rehabilitation tax credit under Section 47 generally computed and claimed?

A. The credit equals 20% of qualified rehabilitation expenditures and is claimed ratably over a 5-year period, not entirely in one year.
B. The credit equals 10% of qualified rehabilitation expenditures and is claimed entirely in the year the rehabilitated building is placed in service.

C. The credit equals 20% of qualified rehabilitation expenditures and is claimed entirely in the year construction begins, before completion.
D. The credit equals 30% of qualified rehabilitation expenditures and is claimed ratably over a 10-year period following completion.

54. A self-employed taxpayer uses a vehicle for both business and personal purposes and wants to substantiate the business-use percentage claimed for depreciation. Under the listed property substantiation rules of Section 274(d), what must the taxpayer maintain?

A. A single annual estimate of total business mileage, prepared from memory at year-end, which is sufficient to substantiate business use.
B. No substantiation is required as long as the vehicle is titled in the business's name rather than the taxpayer's own name.
C. Adequate records or sufficient corroborating evidence, such as a contemporaneous log, showing the amount, date, and business purpose of each use.
D. A signed statement from the taxpayer's return preparer certifying that the claimed business-use percentage is reasonable under the facts.

55. An investor makes a qualified equity investment in a certified Community Development Entity (CDE) that in turn makes qualified low-income community investments. Which credit may the investor claim with respect to this investment?

A. The Low-Income Housing Credit, claimed over a 10-year compliance period based on qualified basis in low-income housing units.
B. The Rehabilitation Tax Credit, claimed over a 5-year period based on qualified rehabilitation expenditures for historic structures.
C. The Employer-Provided Childcare Credit, claimed in the year qualified childcare facility expenditures are incurred by the investor.
D. The New Markets Tax Credit, claimed over a 7-year credit period as a percentage of the qualified equity investment in the CDE.

56. A taxpayer owns several rental properties and wants to rely on the IRS safe harbor to treat the rental real estate enterprise as a trade or business eligible for the QBI deduction. Which requirement must generally be satisfied under this safe harbor?

A. The taxpayer must materially participate in the rental activity under the passive activity loss material participation tests.
B. At least 250 hours of rental services must be performed annually for the enterprise, with contemporaneous records of those services kept.
C. The rental properties must generate positive taxable income in at least three of the preceding five tax years.
D. The taxpayer must rent each property under a written lease with a minimum term of at least twelve months.

57. A restaurant owner pays the employer's share of Social Security and Medicare taxes on tips reported by food and beverage employees. Which credit allows the employer to recover a portion of these payroll taxes?

A. The Section 45B credit for employer Social Security and Medicare taxes paid on employee tips exceeding the federal minimum wage threshold.
B. The Work Opportunity Tax Credit, based on wages paid to tipped employees who were hired from a targeted group.
C. The Section 45S credit for employer-paid family and medical leave benefits provided to tipped food and beverage employees.
D. The disabled access credit for eligible small businesses that incur expenditures to accommodate tipped employees with disabilities.

58. An employer wants to claim the Work Opportunity Tax Credit for a newly hired employee from a targeted group. What procedural requirement must the employer satisfy to obtain certification for this employee?

A. The employer must file Form 3800 with the IRS within 10 days of the employee's start date to request pre-approval.
B. The employer must submit Form 8850, the pre-screening notice, to the state workforce agency generally within 28 days after the employee begins work.
C. The employer must obtain a written statement from the employee's prior employer confirming eligibility before any wages are paid.
D. The employer must withhold an additional payroll tax deposit equal to the anticipated credit amount pending certification.

59. A business owner wants to know which categories of improvements to nonresidential real property may qualify for Section 179 expensing, in addition to standard tangible personal property. Which of the following is eligible?

A. Enlargements of the building's footprint, elevators, escalators, and structural components of the internal framework.

B. Land improvements such as parking lots, landscaping, and fencing surrounding the nonresidential real property.

C. Residential rental property improvements, including new kitchen appliances and flooring installed in individual dwelling units.

D. Roofs, HVAC systems, fire protection and alarm systems, and security systems installed on nonresidential real property.

60. A business does not want to claim bonus depreciation on a class of qualified property it placed in service during the current year. How must the business make this election, and what is the effect once made?

A. The election is made automatically by omitting bonus depreciation from the return, with no formal statement required at all.

B. The election applies only to a single specific asset and must be renewed annually for that one asset going forward.

C. The election must be made by class of property for the year, and once made, is irrevocable without IRS consent.

D. The election may be revoked at any time within three years by filing an amended return for the election year.

61. A taxpayer's qualified trade or business generates a qualified business income loss for the current tax year, resulting in negative overall QBI. How is this negative amount treated for QBI deduction purposes?

A. The negative amount is permanently disallowed and provides no benefit in the current year or any future tax year.

B. The negative amount immediately reduces the taxpayer's wage income for the year, dollar for dollar, outside the QBI computation.

C. The negative amount is carried forward and treated as a loss from a separate qualified trade or business in the next tax year.

D. The negative amount is carried back two years and used to amend the QBI deduction claimed in a prior tax year.

62. A taxpayer operates a real property trade or business and elects out of the business interest expense limitation under Section 163(j) to avoid having interest deductions restricted. What depreciation consequence results from making this election?

A. The taxpayer must depreciate applicable real property under the Alternative Depreciation System (ADS) using its longer recovery periods.

B. The taxpayer becomes ineligible to claim any depreciation deduction on real property used in the electing trade or business.

C. The taxpayer must immediately expense the full remaining basis of all real property in the year the election is made.

D. The taxpayer may continue using regular MACRS recovery periods, since the election has no effect on depreciation at all.

63. A taxpayer exchanges real property used in a trade or business for like-kind replacement real property in a transaction qualifying under Section 1031, with no boot received. How is the replacement property generally depreciated going forward?

A. The replacement property is treated entirely as new property, depreciated over a full recovery period based on its fair market value.

B. The exchanged basis carries over and continues to be depreciated over the remaining recovery period of the relinquished property, with excess basis treated separately.

C. Depreciation on the replacement property is suspended entirely until it is eventually sold in a fully taxable transaction.

D. The taxpayer must immediately recognize and depreciate the entire amount of realized gain from the exchange this year.

64. A patron of a specified agricultural or horticultural cooperative receives a qualified payment from the cooperative for products sold through the cooperative. How does this payment factor into the patron's QBI deduction computation?

A. The payment is entirely excluded from QBI, generating no deduction whatsoever for the patron under Section 199A rules.
B. The payment automatically disqualifies the patron from claiming a QBI deduction on income from any other qualified business.
C. The payment is treated the same as W-2 wages, reducing the patron's overall wage limitation for QBI purposes.
D. The payment is included in QBI but reduced by the lesser of 9% of QBI or 50% of allocable W-2 wages.

65. A homebuilder constructs new energy-efficient dwelling units that meet applicable Energy Star or zero energy ready home program requirements and sells the units to homebuyers. Which credit may the homebuilder claim for these qualifying units?

A. The Section 48 energy investment credit, based on a percentage of the cost of solar property installed on each unit.
B. The Section 179D deduction, available only to designers of energy-efficient systems installed in government-owned buildings.
C. The Work Opportunity Tax Credit, based on wages paid to construction workers who build the qualifying units.
D. The Section 45L New Energy Efficient Home Credit, a per-unit credit available to eligible contractors for qualifying new homes.

66. A business pays $5,000 to an unincorporated contractor for consulting services during the year and separately pays $3,000 in rent to a commercial landlord for its office space. Which statement correctly describes the Form 1099 reporting requirements for these two payments?

A. The $5,000 service payment goes on Form 1099-NEC, due to the recipient and the IRS by January 31; the $3,000 rent payment goes on Form 1099-MISC, due to the IRS later, by February 28 or March 31.

B. The $5,000 service payment goes on Form 1099-MISC, due to the recipient and the IRS by January 31; the $3,000 rent payment goes on Form 1099-NEC, due to the IRS later, by March 31.

C. Both payments are reported together on a single Form 1099-MISC, due to the recipient and the IRS by January 31, since rent and service fees share identical deadlines.

D. Both payments are reported together on a single Form 1099-NEC, due to the recipient and the IRS by February 28, since both amounts exceed the $600 threshold.

67. A worker sells life insurance full-time exclusively for one insurance company, is not a common-law employee under the traditional control test, but meets all of the statutory conditions under IRC Section 3121(d)(3) for a full-time life insurance salesperson. How is this worker treated for federal payroll tax purposes?

A. Treated as a fully independent contractor; no FICA or income tax withholding applies, and all income is reported solely on Form 1099-NEC each year.

B. Treated as a statutory employee; the employer withholds and pays Social Security and Medicare tax on the wages, but not income tax, and the worker reports income and expenses on Schedule C.

C. Treated as an ordinary common-law employee for all purposes; the employer withholds Social Security, Medicare, and income tax, and issues a standard Form W-2.

D. Treated as a statutory nonemployee; no payroll taxes of any kind apply, and payments are reported directly on Schedule 1 as other income.

68. Two related corporations under common control share a group of employees who perform concurrent services for both entities during the year. The corporations designate one of themselves as the common paymaster to disburse wages to these shared employees. What is the primary FICA and FUTA benefit of this arrangement?

A. Each corporation may independently apply the full Social Security and FUTA wage base to the shared employees, effectively doubling the deduction available to the group.

B. The common paymaster becomes entirely exempt from withholding any Social Security or Medicare tax on wages paid to the shared employees for the year.

C. Wages paid to shared employees are treated as paid by a single employer for the Social Security, Medicare, and FUTA wage bases, avoiding duplicate taxation once a base is met.

D. The related corporations may automatically file one consolidated Form 941 and Form 940 covering every employee company-wide, regardless of common paymaster status.

69. A husband and wife are equal partners in a bona fide partnership operating a retail store, and both spouses actively perform services for the business. Unlike the FICA exemption available for a minor child employed in a parent's sole proprietorship, how are the spouses' partnership earnings treated for self-employment tax purposes?

A. Each spouse's distributive share of partnership income is fully subject to self-employment tax; no spousal exemption comparable to the parent-child sole proprietorship exclusion applies to a partnership.
B. Both spouses' partnership income is exempt from self-employment tax, because spouses are treated the same as a parent-child sole proprietorship for FICA exemption purposes.
C. Only the spouse who acts as managing partner owes self-employment tax; the other spouse's distributive share is exempt from tax as family income.
D. The partnership entity itself, rather than either spouse individually, remains liable for paying self-employment tax on the combined distributive shares of income.

70. A worker was treated by a firm as an independent contractor, but the worker believes she should have been treated as a common-law employee and did not file Form SS-8 before her income tax return was due. Which form does the worker use to compute and report her share of uncollected Social Security and Medicare tax on the wages she believes were misclassified?

A. Form 8919 is unavailable unless a completed Form SS-8 determination exists first; the worker must instead report full self-employment tax on Schedule SE.
B. Form 8919, Uncollected Social Security and Medicare Tax on Wages, computes only the employee's share of FICA tax under the applicable reason code, without the employer's matching share.
C. Form 8919 requires the worker to compute and remit both the employee and employer shares of FICA tax, mirroring the Schedule SE computation exactly.
D. Form 8919 must be filed by the firm rather than the worker, to report the firm's own delinquent employment tax liability for the year.

71. A sole proprietor wants to make a SEP IRA contribution for the prior tax year on behalf of herself and her eligible employees. By what deadline must the contribution generally be made for it to be deductible for that prior year?

A. By December 31 of the tax year for which the contribution is made, with no extensions permitted under any circumstance whatsoever.

B. By January 31 of the following year, matching the deadline for furnishing Form W-2 to employees for the prior year.

C. By the due date of the employer's federal income tax return for that year, including any extensions actually obtained by the employer.

D. By April 15 of the following year regardless of any filing extension the employer may have separately obtained for its return.

72. An employer sponsors a SIMPLE IRA plan for its employees. Employee salary reduction contributions must be deposited within 30 days after the end of the month in which they are withheld. By what deadline must the employer generally deposit its own matching or nonelective contribution to the SIMPLE IRA?

A. Within 30 days after the end of the plan year, identical to the deadline that applies to employee salary reduction contributions.

B. By January 31 of the following year, matching the deadline for furnishing Form W-2 wage statements to employees.

C. Within 15 business days after the end of the month for which the employer contribution amount is calculated and determined.

D. By the due date, including extensions, for filing the employer's federal income tax return for that year.

73. An S corporation's sole shareholder performs substantial services for the business but takes only distributions and no salary, attempting to avoid FICA tax entirely on the earnings. How does the IRS generally treat this arrangement upon examination?

A. The arrangement is respected exactly as filed, because S corporation distributions can never be reclassified regardless of the services actually performed.

B. The shareholder's distributions are automatically converted to self-employment income reportable on Schedule SE, entirely bypassing the payroll tax system.

C. The corporation must retroactively convert to a partnership so the shareholder's earnings can instead be taxed as self-employment income.

D. The IRS may recharacterize a portion of the distributions as reasonable compensation subject to FICA tax through Form W-2 wages, based on services performed.

74. A corporation fails to remit the employee income tax and FICA withholding portion of its payroll taxes to the IRS, though it continues paying other business expenses. The company's controller, who had authority to decide which creditors were paid and knowingly chose not to pay the withheld taxes, is later identified by the IRS. What is the controller personally exposed to under these facts?

A. No personal liability results, because payroll tax liability attaches only to the corporate entity regardless of any individual's authority or willfulness.
B. A civil penalty limited strictly to the unpaid employer matching share of FICA tax, assessed solely against the corporation itself.
C. The Trust Fund Recovery Penalty under Section 6672, equal to 100% of the unpaid trust fund taxes, assessed personally against a willful responsible person.
D. Criminal liability only, since Section 6672 provides no civil mechanism for collecting unpaid trust fund taxes from responsible individuals.

75. A taxpayer operates a sole proprietorship selling products wholesale and uses a specifically identified area of her home to store inventory and product samples on a regular basis, though other areas of that same room are used for personal purposes. The home is her only fixed business location. Which special rule may allow a home office deduction for this storage area despite the mixed use?

A. The inventory and product sample storage exception under Section 280A(c)(2), available when the home is the business's sole fixed location and the space is used regularly for storage.
B. The simplified method automatically waives the exclusive-use requirement for any storage space used in a trade or business, regardless of the surrounding facts.
C. The principal-place-of-business test permits mixed personal and business use of any room used for administrative work, including storage areas within that room.
D. No exception applies; inventory storage areas must always satisfy the identical exclusive-use standard that governs an administrative home office.

76. A taxpayer pays a nanny $15,000 during the year to care for her children in the taxpayer's home, and the nanny is properly classified as a household employee rather than an independent contractor. How does the taxpayer generally report and pay the related federal employment taxes?

A. The taxpayer issues the nanny a Form 1099-NEC for the year and has no further federal employment tax reporting obligation of any kind.

B. The taxpayer reports the household employment taxes on Schedule H, filed with the taxpayer's individual Form 1040, instead of a separate quarterly Form 941.

C. The nanny must register as self-employed and pay self-employment tax directly, since household employers are entirely exempt from FICA obligations.

D. The taxpayer must obtain a separate business EIN and file quarterly Form 941 returns exactly as a commercial business employer would.

77. A large food and beverage establishment must allocate tips among its employees when total reported tips fall below a statutory percentage of gross receipts for the period. Which form does the employer use to report both the tips employees reported and any tips allocated to them?

A. Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, filed by certain large food and beverage establishments.

B. Form 941, filed quarterly, is the only required form and separately reports each employee's allocated tip amount directly to the IRS.

C. Form W-2c is used to correct every employee's originally reported tip income once the annual allocation calculation has been completed.

D. Form 8919 is used to report allocated tips because the employer did not directly collect Social Security tax on those amounts.

78. Under the general recordkeeping rules for substantiating items reported on a federal income tax return, for how long must a business generally keep records supporting its income and deduction items, absent a substantial omission of income or fraud?

A. Exactly three years from the filing date or two years from payment, whichever is earlier, with no other retention rule ever applying afterward.

B. As long as the records may be relevant to establishing income or deductions, which generally tracks the applicable period of limitations, typically at least three years.

C. Exactly six years from the return's due date in every case, regardless of whether any understatement or omission of income occurred.

D. Indefinitely in all cases, because the IRS retains authority to examine any return at any time regardless of when it was filed.

79. An employer must file 10 Forms W-2 and 15 Forms 1099-NEC for the year, a combined total of 25 information returns. Under current IRS regulations, how must these returns generally be filed with the IRS?

A. On paper, because the employer's total falls well under the historical 250-return threshold that formerly applied to information return filers.
B. In whatever format the employer prefers, since only Forms 1099 count toward any electronic filing threshold, never Forms W-2 wage statements.
C. Electronically, because the aggregate count of all information returns filed by the employer reaches the current 10-return electronic filing threshold.
D. Electronically for the Forms 1099-NEC only; the Forms W-2 may still be filed on paper regardless of the employer's aggregate count.

80. A grantor establishes a dynasty trust intended to benefit children, grandchildren, and later descendants for as long as state law permits, without transfer tax being triggered at each successive generational level. To shield the trust's assets from the generation-skipping transfer tax as they pass to grandchildren and beyond, what must the grantor do?

A. File Form 706 to elect portability of the grantor's unused estate tax exclusion to the surviving spouse
B. Rely on the trust's classification as a complex trust to automatically avoid GST tax exposure
C. Distribute all trust accounting income annually so that no corpus remains subject to GST tax
D. Affirmatively allocate GST exemption to transfers funding the trust, typically reported on a timely Form 709

81. A decedent leaves property outright to a surviving spouse who is not a United States citizen. Because the unlimited marital deduction is unavailable in this situation, what device allows the estate to defer estate tax on the transferred property until it is later distributed or the spouse becomes a citizen?

A. A revocable living trust naming the noncitizen spouse as sole trustee and lifetime beneficiary
B. A qualified domestic trust that meets Section 2056A requirements, including a U.S. trustee
C. A generation-skipping dynasty trust funded with the decedent's remaining applicable exclusion amount
D. A qualified terminable interest property trust electing marital deduction treatment on Form 706

82. An heir wants to refuse an inheritance so that the property passes instead to the next taker under the decedent's will, without the refusal itself being treated as a taxable gift from the heir. Which requirement must the disclaimer satisfy to qualify under Section 2518?

A. The disclaimer may be made orally as long as it is later confirmed in writing before the estate closes

B. The heir may direct exactly who receives the disclaimed property in place of the default taker

C. The disclaimer must be in writing, irrevocable, and delivered within nine months of the transfer creating the interest

D. The heir may accept partial benefits from the property before disclaiming the remaining interest

83. The generation-skipping transfer tax applies to three distinct types of transfers: a direct skip, a taxable termination, and a taxable distribution. Which statement correctly distinguishes how these events are taxed?

A. A direct skip is taxed on the amount the skip person receives, while both a taxable termination and taxable distribution are taxed net of certain allowable expenses

B. All three transfer types are taxed under one identical valuation formula, meaning no meaningful distinction exists among a direct skip, termination, or distribution

C. Only a direct skip triggers generation-skipping transfer tax liability, since taxable terminations and taxable distributions are both fully exempt from the tax by statute

D. A taxable distribution is always paid personally by the trustee, while a direct skip is always paid directly out of the underlying trust itself

84. A trust is structured as a charitable remainder unitrust, providing an annual payment to a noncharitable beneficiary for life with the remainder passing to a qualified charity. Which annual return must the trustee file to report the trust's financial activities to the IRS?

A. Form 1041 alone, since split-interest charitable trusts are exempt from any separate information return

B. Form 990-PF, because every split-interest charitable trust is automatically treated as a private foundation

C. Form 5500, since the trust is treated as a funded employee welfare benefit arrangement

D. Form 5227, the annual information return required specifically for split-interest charitable trusts

85. A rancher is forced to sell more cattle than she normally would because severe drought has destroyed her available grazing land and water supply. She wants to defer recognizing gain on the excess sales by replacing the herd. Under Section 1033(e), how long does she generally have to replace the livestock?

A. Two years after the close of the first tax year the gain is realized, extended to four years for a federally declared disaster area

B. Exactly six months from the date of the forced sale of the livestock, with no extensions available under any circumstances whatsoever

C. Ninety days from the date drought conditions are officially declared over by the relevant state agricultural authorities

D. One full calendar year, matching the separate deadline that applies to the weather-related sale income deferral election

86. A cash-method farmer's crop is destroyed by a hailstorm, and she receives crop insurance proceeds that would normally be taxable in the year received. She would ordinarily have sold the crop in a later year. Under Section 451(d), what may she elect to do with these proceeds?

A. Exclude the proceeds from gross income permanently, treating them as a nontaxable return of basis in the destroyed crop

B. Spread the proceeds ratably over the following three tax years regardless of when the crop would normally have been sold

C. Defer reporting the proceeds until the tax year following the year of receipt, if she can show the crop would normally have been sold in a later year

D. Report the proceeds in the year of receipt but exclude the portion attributable to any deductible casualty loss

87. A decedent's will leaves property in trust giving the surviving spouse a mandatory annual income interest for life, with the remainder passing to the decedent's children from a prior marriage rather than to the spouse. What allows the estate to claim the marital deduction for this terminable interest?

A. The spouse must be given an unrestricted general power to withdraw the entire trust principal at any time

B. The trust must terminate automatically and distribute outright to the spouse within five years of the decedent's death

C. The remainder beneficiaries must be limited exclusively to the decedent's grandchildren rather than any other descendants

D. The executor makes a qualified terminable interest property election on Form 706 under Section 2056(b)(7)

88. An estate's assets have declined significantly in value in the months following the decedent's death. The executor wants to value the gross estate at a later date than the date of death to reduce the estate's tax liability. Under Section 2032, what condition must be met to use this alternate date?

A. The alternate date may be chosen freely for any estate regardless of its effect on total estate tax owed

B. The election must decrease both the value of the gross estate and the estate tax liability to be allowed

C. The alternate date applies automatically to any estate that owes no federal estate tax after the applicable credit

D. The executor must obtain court approval before valuing any estate asset on a date other than the date of death

89. A policyholder transfers an existing life insurance policy on her own life into an irrevocable life insurance trust, giving up all incidents of ownership. She dies twenty months later. How is the policy's death benefit treated for estate tax purposes?

A. The proceeds are excluded from the gross estate because the trust, not the decedent, held the policy at death

B. The proceeds are includible in the gross estate under the three-year rule of Section 2035

C. Only the portion of the premiums paid by the decedent within three years of death is included in the estate

D. The proceeds are excluded because incidents of ownership were fully relinquished before the transfer took effect

90. An estate incurs substantial administration expenses, including executor fees and legal costs, that are deductible under Section 2053 in computing the taxable estate on Form 706. The estate also has significant income reported on Form 1041. What must the executor do to deduct these same expenses on the estate's income tax return instead?

A. Nothing further is required; identical expenses may always be deducted in full on both Form 706 and Form 1041

B. The expenses must be capitalized and amortized over the estate's remaining administration period rather than deducted currently

C. The executor must file a statement under Section 642(g) waiving the estate tax deduction for those expenses

D. The expenses become nondeductible on both returns once the estate has claimed any deduction on Form 706

91. A decedent's gross estate consists primarily of an interest in a closely held business, and the estate lacks sufficient liquid assets to pay the estate tax due nine months after death. If the business interest exceeds 35% of the adjusted gross estate, what relief provision may the executor elect?

A. An election under Section 6166 to pay the estate tax attributable to the business interest in installments over up to fourteen years

B. An automatic three-year extension of the filing deadline for Form 706 with no interest accruing on the unpaid balance

C. A permanent waiver of estate tax on the business interest as long as the heirs continue operating it

D. A mandatory conversion of the business interest into marketable securities to satisfy the estate tax liability

92. A trust instrument gives a beneficiary the power to appoint trust principal to herself, her estate, her creditors, or the creditors of her estate. How is this power classified, and what is its effect on the beneficiary's gross estate under Section 2041?

A. It is a limited power of appointment, and the trust property is excluded from the beneficiary's gross estate

B. It is a special power of appointment, includible only if actually exercised before the beneficiary's death

C. It is a testamentary power that has no estate tax consequence unless granted by a will rather than a trust

D. It is a general power of appointment, and the trust property is includible in the beneficiary's gross estate

93. A donor funds an irrevocable trust that pays a fixed annuity to a qualified charity for a term of fifteen years, after which the remaining trust principal passes to the donor's children. How does this arrangement differ from a charitable remainder trust?

A. It does not, since both trust types pay the charity first and the noncharitable beneficiary the remainder interest

B. It differs only in that a charitable remainder trust cannot use a fixed annuity payment structure at all

C. The income interest goes to charity first, with the remainder passing to noncharitable beneficiaries, the reverse of a charitable remainder trust

D. It differs only in that this arrangement can never qualify the donor for any current charitable income tax deduction

94. A Section 501(c)(3) public charity's board wants the organization to publicly endorse a candidate for local office and contribute funds to that candidate's campaign. Under federal tax law, is this activity permitted for an organization exempt under Section 501(c)(3)?

A. Yes, as long as the total expenditure on the endorsement and contribution stays under the applicable insubstantial-activity threshold

B. Yes, provided the organization makes a Section 501(h) election to measure its campaign activity under an expenditure test

C. Yes, but only if the endorsement is issued in the organization's own name rather than an officer's individual name

D. No, participation or intervention in any political campaign for or against a candidate is absolutely prohibited for 501(c)(3) organizations

95. A public charity engages in a meaningful amount of legislative lobbying activity each year and wants a more objective, dollar-based measure of how much lobbying it may conduct without jeopardizing its exempt status, instead of relying on the vaguer 'no substantial part' standard. What election is available?

A. A Section 501(h) election, allowing lobbying to be measured against expenditure limits based on a percentage of exempt purpose expenditures

B. A Section 4941 election, converting the organization's lobbying activity into a self-dealing transaction subject to excise tax

C. A Section 509(a)(3) election, reclassifying the organization as a supporting organization exempt from lobbying limits entirely

D. A Section 4947 election, treating the organization as a split-interest trust not subject to any lobbying restriction

96. An organization seeking to avoid classification as a private foundation must demonstrate broad public support rather than reliance on a small number of donors. Under the public support test applicable to organizations described in Section 509(a)(1) and 170(b)(1)(A)(vi), what is the general threshold for qualifying automatically as publicly supported?

A. At least 85% of total support must come from a single governmental unit or related governmental agency

B. At least one-third of total support must come from the general public, governmental units, and other public charities

C. At least 51% of the organization's board members must be unrelated to any substantial contributor by blood or marriage

D. At least 90% of total support must come from investment income generated by the organization's own endowment

97. A private foundation's investment committee places a significant portion of the foundation's endowment into highly speculative options trading and uncovered short positions, without regard to the foundation's need to carry out its charitable purposes. Under Section 4944, what tax consequence applies to this type of investment?

A. No excise tax applies, since foundations have complete discretion over investment strategy under the prudent investor standard

B. The investment automatically converts the organization from a private foundation into a private operating foundation

C. An excise tax applies to jeopardizing investments that risk the foundation's ability to carry out its exempt purposes

D. The investment triggers only a reporting requirement on Form 990-PF with no associated excise tax

98. A private foundation makes a grant directly to an individual for travel and study purposes without following any pre-approved, IRS-sanctioned grant-making procedure, and separately makes a grant to a foreign organization without exercising expenditure responsibility. Under Section 4945, how are these grants generally treated?

A. Both grants are fully permissible because private foundations face no restrictions on grants to individuals or foreign organizations

B. Both grants are taxable expenditures subject to excise tax unless proper procedures, such as an approved grant plan or expenditure responsibility, are followed

C. Only the grant to the foreign organization is restricted; grants to individuals are entirely unregulated under federal tax law

D. Both grants are treated as self-dealing transactions between the foundation and a disqualified person under Section 4941

99. A taxpayer converts a traditional IRA to a Roth IRA this year and then withdraws the converted funds eighteen months later, before turning 59½. She has never made a regular Roth contribution before. Assuming no exception applies, what is the tax consequence of this early withdrawal of converted funds?

A. The withdrawal is entirely tax-free and penalty-free because Roth IRA earnings are never taxed once converted

B. The withdrawal triggers ordinary income tax on the entire amount withdrawn, including the original converted principal

C. The withdrawal is tax-free but subject only to a state-level penalty, since no federal penalty applies to Roth conversions

D. The amount is not taxed again as income, but is subject to a 10% additional tax for failing the five-year conversion holding period

100. A participant in an employer's qualified retirement plan holds employer stock in her account that has appreciated substantially in value since it was contributed. Upon a lump-sum distribution from the plan, what tax planning strategy allows her to defer tax on the stock's appreciation until she later sells it, and tax that appreciation at capital gains rates?

A. Electing net unrealized appreciation treatment on the employer stock distributed in a qualifying lump-sum distribution

B. Rolling the entire distribution, including the employer stock, into a traditional IRA and withdrawing it immediately

C. Electing ten-year forward income averaging on the full fair market value of the distributed employer stock

D. Requesting the plan trustee to sell the stock internally before distribution to lock in ordinary income treatment

Answer Key and Explanations — Practice Exam 18, Part 2: Businesses

1. C — When a partnership divides, the resulting partnership whose partners owned more than 50% of the prior partnership's capital and profits interests is treated as its continuation, retaining its taxpayer identification number and tax attributes. Any other resulting partnership is treated as a newly formed entity, even though the division itself uses the assets-over transfer mechanics described above.

2. B — Unlike the default assets-over form, the assets-up form requires the terminating partnership to actually distribute its assets and liabilities to its own partners first. Those partners then contribute the assets directly to the surviving partnership in exchange for interests. This alternative structure can change the partners' basis and holding period results compared to the assets-over default.

3. A — The Section 752 regulations allocate nonrecourse liabilities among partners in three sequential tiers: first, each partner's share of partnership minimum gain; second, any Section 704(c) built-in gain minimum gain attributable to contributed property; and third, any remaining excess nonrecourse liability allocated according to the partners' shares of partnership profits under the agreement.

4. D — Publicly traded partnerships are generally taxed as corporations, but Section 7704(c) provides an exception: if at least 90% of gross income consists of qualifying passive-type income, such as interest, dividends, real property rents, or natural resource income, the partnership continues receiving pass-through partnership taxation despite its interests trading on an established securities market.

5. C — Section 706(d) requires a partnership to account for a partner's varying interest during the year when a partner's interest changes, generally through either an interim closing of the books at the change date or a proration method spreading full-year items based on the number of days each ownership percentage was in effect, rather than ignoring the mid-year change entirely.

6. B — An abandoned partnership interest generally produces an ordinary loss under Section 165, because no sale or exchange has taken place. However, if the abandoning partner is instead relieved of her share of partnership liabilities, that relief is treated as deemed consideration, converting the transaction into a sale or exchange under Section 741 that produces a capital loss.

7. A — Section 707(b) disallows losses on sales or exchanges between a partnership and a partner who owns, directly or indirectly, more than 50% of the capital or profits interest. Because this partner holds a

60% interest, the related-party rule applies, and the entire loss on the equipment sale is disallowed for federal income tax purposes going forward.

8. C — Under the majority interest taxable year rule of Section 706(b), a partnership must generally adopt the taxable year used by one or more partners owning more than 50% of both capital and profits interests. Since those majority partners all use a calendar year, the partnership is required to adopt the calendar year as its required year.

9. D — With a valid Section 754 election in effect, Section 734(b) requires the partnership to increase the basis of its remaining property when a distributee partner recognizes gain because a cash distribution exceeded her outside basis. This adjustment prevents double taxation of the same economic gain to the remaining partners as partnership property is later sold.

10. A — Section 704(d) limits a partner's deductible distributive share of partnership loss to her outside basis, here $30,000. The disallowed $20,000 is not permanently lost; it is suspended and carried forward indefinitely, becoming deductible in a later year once additional contributions, income allocations, or other events increase her outside basis above zero once again.

11. D — Net earnings from self-employment equal net profit multiplied by 92.35%, here $40,000 times 0.9235 equals $36,940, reflecting the employer-equivalent portion excluded from the tax base. Because net earnings from self-employment exceed $400, Schedule SE must be filed and self-employment tax computed on the $36,940 figure, subject to the annual Social Security wage base limit.

12. B — Section 751(b) prevents partners from using distributions to shift their share of hot assets, such as substantially appreciated inventory, to other partners without recognizing ordinary income. When a distribution disproportionately reduces a partner's interest in hot assets relative to other partnership property, the transaction is treated in part as a taxable exchange producing ordinary income to her.

13. C — Section 1402(a)(1) generally excludes rental income from real estate, along with related deductions, from net earnings from self-employment, regardless of how many properties an individual owns. This exclusion does not apply if the owner is instead a real estate dealer or provides substantial services to tenants that go beyond what is customary for space rental.

14. A — A guaranteed payment is deductible by the partnership under its own method of accounting, but is includible in the recipient partner's income for the partner's tax year within which, or with which, the partnership's tax year ends, regardless of the partner's own differing tax year, and regardless of when the payment is actually received in cash.

15. B — Under Section 707(a)(1), when a partner engages in a transaction with the partnership other than in her capacity as a partner, such as leasing property to it at a fair rental rate, the transaction is treated as occurring between the partnership and an outside party. She reports the rent as rental income, not as a distributive share item.

16. D — When no majority interest taxable year exists, Section 706(b) next applies the least aggregate deferral method. This calculation tests each taxable year used by any principal partner and selects the year that produces the smallest weighted total income deferral across all partners, based on their relative interests in partnership profits for the year in question.

17. C — A sole proprietorship is not itself a distinct tax entity, so its sale is not treated as the sale of one single asset. Under the aggregate theory established in Williams v. McGowan, the transaction is broken into separate sales of each underlying asset, such as inventory, equipment, and goodwill, each characterized and taxed under its own applicable rules.

18. D — The prior-year safe harbor generally requires estimated payments equal to 100% of the prior year's tax liability, but for taxpayers whose prior-year adjusted gross income exceeded $150,000, that threshold rises to 110%. Paying at least this amount through timely estimated payments avoids an underpayment penalty even if current-year tax liability turns out much higher.

19. A — Under Section 304(a)(1), when a shareholder controlling two commonly held (brother-sister) corporations sells stock of one to the other for property, the transaction is recast as a redemption of the acquiring corporation's stock, then tested under Section 302 to determine dividend versus sale or exchange treatment based on the resulting ownership change.

20. B — Section 306 stock (the 'preferred stock bailout' stock) received tax-free as a stock dividend is taxed specially on later disposition: gain from a sale, rather than a redemption, is treated as ordinary income up to the stock's ratable share of earnings and profits existing at the time of the original distribution.

21. A — To qualify as a tax-free spin-off under Section 355, both the distributing and controlled corporations must have actively conducted a qualifying trade or business for at least five years before the distribution, and that business generally cannot have been acquired in a taxable transaction during that period. A newly purchased business fails this requirement.

22. C — Section 165(g) treats worthless securities as if sold or exchanged on the last day of the tax year, generally producing a capital loss subject to capital loss limitations. Section 1244 is a narrow exception allowing qualifying small business stock to produce an ordinary loss instead, up to statutory caps, only when its own requirements are separately met.

23. D — Unlike individuals, C corporations may not deduct net capital losses against ordinary income in any year. A corporate net capital loss is instead carried back 3 years and carried forward up to 5 years, applied only against capital gains realized in those years, and treated as short-term regardless of its original character.

24. B — The dividends-received deduction is tiered by the recipient corporation's ownership stake in the payor: 50% for ownership under 20%, 65% for ownership of at least 20% but less than 80%, and 100% for qualifying affiliated-group ownership of 80% or more. At 45% ownership, Corporation A's dividend falls in the 65% tier.

25. D — Section 1361(b)(2) bars certain entities from S status regardless of otherwise meeting shareholder or stock-class requirements, including insurance companies taxed under subchapter L, banks using the reserve method for bad debts, domestic international sales corporations, and corporations electing possessions tax credit treatment. An ordinary restaurant, retailer, or single-shareholder corporation raises no such disqualification.

26. A — Under Section 6901 and related transferee liability doctrine, the IRS may pursue a shareholder or other transferee who received corporate assets in a liquidation or distribution for the corporation's unpaid tax, generally limited to the value of assets received, once the corporation itself cannot satisfy the liability. This prevents distributions from defeating legitimate tax collection.

27. B — Section 304(a)(2) applies when a controlling shareholder sells stock of a parent corporation to a subsidiary the parent controls. Unlike the brother-sister rule of Section 304(a)(1), this parent-subsidiary variant recasts the sale as a redemption of the parent's own stock by the subsidiary, still tested under Section 302 for dividend versus exchange treatment.

28. C — Section 332 provides nonrecognition for a parent corporation that liquidates an 80%-or-more-owned subsidiary: the parent generally recognizes no gain or loss on the liquidating distribution and takes a carryover basis in the assets received, unlike the general rule where liquidating distributions to non-controlling shareholders trigger gain recognition at both the corporate and shareholder levels.

29. A — Section 382 limits, but does not eliminate, a loss corporation's use of pre-change NOL carryforwards after an ownership change exceeding 50 percentage points within the testing period. The annual limitation generally equals the corporation's equity value immediately before the change multiplied by the long-term tax-exempt rate, preventing loss trafficking through stock acquisitions.

30. C — Section 269 allows the IRS to disallow a deduction, credit, or other tax allowance when a person acquires control of a corporation, or a corporation acquires property from another corporation, principally to secure a tax benefit such as loss carryforwards that would not otherwise be available, targeting acquisitions lacking genuine business purpose beyond tax avoidance.

31. D — When a shareholder's loans to an S corporation have been reduced by prior passed-through losses, current-year income allocated to that shareholder generally restores the reduced debt basis first, before any excess increases stock basis. This ordering, under Section 1367 and related regulations, differs from the loss-deduction ordering, which reduces stock basis before debt basis.

32. B — Most state LLC statutes limit a personal judgment creditor of an individual member to a charging order, which attaches only to distributions the member would otherwise receive, without granting management rights, voting rights, or a right to seize LLC assets directly. This protects the LLC's other members from disruption caused by one member's personal creditors.

33. C — Once a valid QSub election is made, the subsidiary is treated for federal income tax purposes as if it liquidated into its parent S corporation, becoming a disregarded entity whose assets, liabilities, income, and deductions are reported directly on the parent's own return, rather than filing a separate corporate return.

34. B — Section 267(a)(1) disallows losses realized on sales or exchanges of property between related parties, including a corporation and a shareholder owning more than 50% of its stock. This differs from

Section 267(a)(2)'s timing-matching rule for accrued deductions and from Section 1239's recharacterization of gain, since here the loss is disallowed outright, not merely deferred.

35. A — For an S election to be valid, all persons who were shareholders at any time during the portion of the tax year before the election is filed must consent, in addition to those who are shareholders on the day the election is actually made. A shareholder who left mid-year must still consent for that year's election.

36. D — Taxpayers may adopt a hybrid method, combining cash and accrual accounting for different, separately identifiable segments of a business, provided the combination clearly reflects income and is applied consistently. The accrual method is still required for purchases and sales tied to inventory, while the cash method may remain available for the segment without inventory.

37. A — Section 461(f) allows an accrual-method taxpayer to deduct a contested liability in the year it transfers money or property to provide for satisfaction of the asserted liability, continues contesting it, and the liability would otherwise be deductible. Deduction is not delayed until the contest concludes, distinguishing this rule from ordinary all-events-test timing.

38. B — Commissions paid to acquire a lease are capital expenditures because they produce a benefit lasting beyond the current year, the lease term itself. These costs must be capitalized and amortized ratably over the lease term, rather than deducted currently, distinguishing them from ordinary operating expenses such as rent paid during occupancy.

39. C — The LIFO conformity requirement of Section 472(c) generally bars a taxpayer using LIFO for tax purposes from reporting inventory or income using a different method in financial statements furnished to shareholders, creditors, or other outside parties. Violating conformity by presenting non-LIFO income externally can cause the IRS to disallow the LIFO election entirely.

40. D — Under Section 448, most C corporations exceeding the inflation-adjusted average annual gross receipts threshold, other than qualified personal service corporations, may not use the cash method. Once the threshold is exceeded, the corporation must switch to the accrual method, generally requesting IRS consent by filing Form 3115 and reporting any resulting Section 481(a) adjustment.

41. D — Regulations under Section 471 permit a taxpayer to value obsolete, damaged, or otherwise subnormal goods at their bona fide selling price, even if below cost, rather than at full inventory cost, provided the goods are actually offered for sale within a reasonable time. This exception does not generally apply to inventory valued using the LIFO method.

42. C — Under the avoided-cost method of Section 263A(f), a taxpayer with self-constructed property must capitalize interest on debt that could have been repaid with funds used for construction, computed using the rates on outstanding debt, even though that debt was not directly traced to the project. This applies once traced construction debt is exceeded.

43. A — For resellers subject to Section 263A, the costs of operating a purchasing department, including labor and overhead directly related to purchasing inventory, are additional Section 263A costs that must be capitalized and allocated to the inventory acquired, rather than deducted currently as ordinary administrative or selling expenses incurred entirely elsewhere.

44. B — The percentage of completion equals costs incurred to date divided by estimated total costs: $200,000 divided by $800,000 equals 25%. That percentage is applied to total expected gross profit of $200,000 ($1,000,000 contract price minus $800,000 estimated costs), producing $50,000 of gross contract income recognized for the current year under Section 460.

45. D — Section 460's look-back method requires a contractor to recompute the tax liability for each year of a completed long-term contract as if the final contract price and costs had been known at the time, then pay interest on any resulting underpayment or receive interest on any overpayment, rather than amending the original returns.

46. C — Home construction contracts, where at least 80% of estimated costs relate to dwellings in buildings of four or fewer units, are exempt from the percentage-of-completion requirement regardless of contract length or the contractor's gross receipts. Qualifying homebuilders may instead use the completed-contract method or another otherwise permissible exempt method for these contracts.

47. B — Under the claim-of-right doctrine, income received without restriction is taxable when received even if it must later be repaid. Section 1341 lets the taxpayer generally deduct the repayment in the year of repayment, or, if the repayment exceeds $3,000 and produces a better result, recompute tax as though the original income had not been received.

48. A — Bartering is a taxable exchange: each party must include in gross income the fair market value of the property or services received in exchange for its own services, regardless of whether cash changes hands. Each business may also deduct the value of services provided as a business expense if the expense would otherwise be deductible.

49. B — Under Section 453(e), when a related-party first purchaser resells installment-sale property within two years of the original sale, before the original seller has collected all payments, the amount the related party realizes on the resale generally accelerates recognition of the original seller's remaining deferred gain, preventing the family from using installment reporting to defer tax indefinitely.

50. A — Section 447 generally requires C corporations engaged in farming to use the accrual method of accounting, unlike most other C corporations that may qualify for the cash method under Section 448. Narrow exceptions exist for family farming corporations and smaller farming corporations meeting specified gross receipts requirements, allowing them to continue using the cash method.

51. C — Nonresidential real property and residential rental property use the mid-month MACRS convention, treating property as placed in service at the midpoint of the actual month of acquisition, regardless of the exact calendar day. This differs from the half-year and mid-quarter conventions, which apply instead to most tangible personal property under MACRS.

52. D — When Section 179 property's business use drops to 50% or below during its recovery period, recapture applies: the taxpayer reports as ordinary income, on Form 4797, the excess of the Section 179 deduction claimed over the regular MACRS depreciation that would otherwise have been allowable had the election never been made.

53. A — Under Section 47, the rehabilitation credit for certified historic structures equals 20% of qualified rehabilitation expenditures. Unlike most credits claimed fully in the placed-in-service year, this credit is instead claimed ratably in equal annual installments over a five-year period beginning when the rehabilitated building is first placed in service by the taxpayer.

54. C — Section 274(d) requires adequate records or sufficient corroborating evidence for listed property such as vehicles, meaning a contemporaneous log or comparable documentation recording the amount, date, and business purpose of each use. Later estimates, mere titling in the business name, or a preparer's statement alone do not satisfy this standard.

55. D — The New Markets Tax Credit under Section 45D rewards qualified equity investments in certified Community Development Entities that finance low-income community investments. Investors claim the credit over a seven-year credit period as a percentage of the amount invested, a structure clearly distinct from the housing, rehabilitation, and employer childcare credits described elsewhere.

56. B — The IRS rental real estate safe harbor generally requires at least 250 hours of rental services performed annually with respect to the enterprise, along with maintenance of contemporaneous records documenting hours worked, services performed, dates, and who performed them, so the activity can be treated as a QBI trade or business.

57. A — Section 45B allows food and beverage employers to claim a credit for the employer's share of Social Security and Medicare taxes paid on employee tips that exceed what would be attributable to the federal minimum wage, offsetting the added payroll tax cost that comes with employees reporting significant tip income.

58. B — To claim the Work Opportunity Tax Credit, an employer must submit Form 8850, the pre-screening notice and certification request, to the designated state workforce agency generally within 28 days after the targeted-group employee begins work, and obtain certification before the credit can properly be claimed on the employer's federal income tax return.

59. D — Section 179 permits expensing certain qualified improvements made to nonresidential real property after the building itself is first placed in service, including roofs, HVAC systems, fire protection and alarm systems, and security systems. Structural enlargements, elevators, escalators, and internal structural framework components, however, remain specifically ineligible for the Section 179 election.

60. C — A taxpayer electing out of bonus depreciation must make the election by class of property for the taxable year the property is placed in service, typically by attaching a statement to a timely filed original return. Once properly made, the election is irrevocable and binding without first obtaining consent from the IRS.

61. C — A negative QBI amount generated by one qualified trade or business is netted against positive QBI from the taxpayer's other qualified businesses; any remaining negative total carries forward and is treated as a loss from a separate qualified trade or business in the following tax year, reducing that year's deduction.

62. A — A real property trade or business that elects out of the Section 163(j) interest expense limitation must instead depreciate its nonresidential real property, residential rental property, and qualified improvement property under the Alternative Depreciation System, accepting ADS's longer recovery periods in exchange for avoiding the business interest expense limitation entirely going forward.

63. B — For post-2017 real property exchanges qualifying under Section 1031, the replacement property's exchanged basis, carried over from the relinquished property, continues to be depreciated over the relinquished property's remaining recovery period, while any additional excess basis actually paid is separately treated as newly placed-in-service property with its own fresh recovery period.

64. D — Qualified payments from specified agricultural or horticultural cooperatives are included in the patron's QBI, but the patron's Section 199A deduction attributable to that income is reduced by the lesser of 9% of the QBI allocable to the qualified payment, or 50% of the W-2 wages properly allocable to that same payment.

65. D — Section 45L provides eligible contractors a per-unit credit for new energy-efficient homes meeting Energy Star or zero energy ready home program requirements. It is distinct from the Section 48 investment credit, the Section 179D commercial building deduction, and the Work Opportunity Tax Credit, each of which targets different taxpayers and property types.

66. A — Nonemployee compensation for services is reported on Form 1099-NEC, due to both the recipient and the IRS by January 31 with no automatic extension. Rent paid to a landlord is reported on Form 1099-MISC, due to the recipient by January 31 but to the IRS by February 28 (paper) or March 31 (electronic).

67. B — Section 3121(d)(3) designates certain workers, including full-time life insurance salespeople, agent-drivers, home workers, and traveling salespeople, as statutory employees when specified contractual and investment conditions are met. Their wages are subject to Social Security and Medicare withholding, but not federal income tax withholding, and they report income and related business expenses on Schedule C rather than Schedule A.

68. C — Under the common paymaster rules, related corporations that share concurrent employees and designate a common paymaster are treated as a single employer for purposes of the Social Security, Medicare, and FUTA wage bases. This prevents each corporation from separately restarting the wage base on the same employee, avoiding duplicate FICA and FUTA taxation that would otherwise occur.

69. A — The FICA exemption for wages paid to a child under age 18 employed in a parent's sole proprietorship is narrow and does not extend to a partnership, even one owned entirely by family members. Each spouse-partner's distributive share of ordinary business income from a bona fide partnership is fully subject to self-employment tax on Schedule SE.

70. B — A worker who believes she was misclassified as an independent contractor may file Form 8919 to report and pay only her employee share of Social Security and Medicare tax on the wages, using one of the listed reason codes. This avoids the full self-employment tax that Schedule SE would otherwise impose, since the employer share remains the firm's separate liability.

71. C — Employer SEP contributions are deductible for a given tax year if made by the due date of the employer's federal income tax return for that year, including extensions actually obtained. This gives a sole proprietor who files an extension additional time, unlike a fixed calendar deadline, to fund contributions for herself and eligible employees for the prior year.

72. D — Unlike employee salary reduction amounts, which must reach the SIMPLE IRA within 30 days after the month withheld, the employer's own matching or nonelective contribution follows a more generous deadline: the due date, including extensions, of the employer's federal income tax return for the year. This gives the employer added flexibility to fund its share.

73. D — Courts and the IRS have consistently held that an S corporation shareholder-employee who performs substantial services must be paid reasonable compensation before nondividend distributions. On examination, the IRS may recharacterize part of the distributions as W-2 wages subject to FICA tax, based on comparable compensation for similar services, to prevent avoidance of employment taxes.

74. C — Section 6672 authorizes the Trust Fund Recovery Penalty, a civil penalty equal to 100% of unpaid withheld income and FICA taxes, assessed personally against any responsible person who willfully failed to collect, account for, or pay them over. A controller with authority over which creditors to pay who knowingly diverted withheld taxes elsewhere fits this standard.

75. A — Section 280A(c)(2) provides a narrow exception to the exclusive-use requirement for space used on a regular basis to store inventory or product samples, but only when the home is the sole fixed location of the retail or wholesale business. This allows a deduction even though the same area is occasionally used for personal purposes.

76. B — Wages paid to a household employee, such as a nanny, that exceed the annual threshold trigger FICA obligations that a taxpayer generally reports on Schedule H, attached to the taxpayer's individual Form 1040, rather than on a quarterly Form 941. Federal income tax withholding is optional unless the employee requests it and the employer agrees.

77. A — Large food and beverage establishments where tipping is customary must file Form 8027 annually to report total receipts, reported tips, and any tips allocated among employees when reported tips fall below 8% of gross receipts. Allocated tips are also shown in a separate box on each affected employee's Form W-2, but Form 8027 is the employer-level information return.

78. B — Section 6001 and related guidance require taxpayers to keep records as long as they may be relevant to establishing income, deductions, or credits claimed on a return, which generally tracks the open statute of limitations. That period is typically three years, but extends to six years for a substantial omission of income exceeding 25%, or indefinitely if fraud is involved.

79. C — Current IRS regulations lowered the electronic filing threshold to 10, applied by aggregating substantially all information return types an employer files during the year, including Forms W-2 and

1099-NEC together. Because this employer's combined total of 25 returns exceeds that threshold, all of the returns must generally be filed electronically rather than on paper.

80. D — A dynasty trust escapes generation-skipping transfer tax only if the grantor affirmatively allocates GST exemption to transfers funding it, usually reported on a timely Form 709. Without that allocation the inclusion ratio is not zero, so later distributions to skip persons trigger GST tax. Portability under Form 706 concerns the estate tax exclusion, a separate concept.

81. B — Section 2056(d) denies the unlimited marital deduction for transfers to a noncitizen spouse unless property passes through a qualified domestic trust satisfying Section 2056A. A QDOT must have at least one U.S. trustee authorized to withhold estate tax on corpus distributions, deferring tax until principal is distributed or the spouse becomes a citizen.

82. C — A qualified disclaimer under Section 2518 must be an irrevocable, unqualified written refusal delivered within nine months of the transfer, or the disclaimant turning twenty-one, if later. The disclaimant cannot have accepted the property's benefits and cannot direct where it goes; the interest must pass without direction, typically to whoever takes next under the governing instrument.

83. A — A direct skip is valued and taxed on the amount the skip person receives, with the transferor generally liable. A taxable termination is taxed on trust property net of expenses connected with the termination, paid by the trustee. A taxable distribution is taxed on the amount received, net of expenses, but liability falls on the transferee.

84. D — Split-interest charitable trusts, including charitable remainder trusts, charitable lead trusts, and pooled income funds, must file Form 5227 annually to report financial activities, distributions, and compliance with charitable and noncharitable interests. A trust with unrelated business taxable income may also need Form 1041, but Form 5227 is the required return specific to these arrangements.

85. A — Livestock sold because of drought, flood, or other weather-related conditions qualify as an involuntary conversion under Section 1033(e) if replaced with similar or related property. The standard replacement period is two years after the close of the first tax year gain is realized, extended to four years for sales in a federally declared disaster area.

86. C — Section 451(d) permits a cash-method farmer to elect to defer crop insurance proceeds, or certain federal disaster payments, received because of crop destruction or damage, reporting them the tax year following receipt instead. The election requires showing that under normal business practice the crop's income would have been reported in that later year, applied crop by crop.

87. D — Ordinarily a terminable interest, such as a life income interest with remainder to someone other than the spouse, does not qualify for the marital deduction. Under Section 2056(b)(7), the executor may elect QTIP treatment on Form 706 for property giving the spouse a qualifying life income interest, allowing the deduction now while including the trust in the spouse's estate later.

88. B — Section 2032 allows an executor to elect an alternate valuation date, generally six months after death, instead of the date-of-death value. The election is available only if it decreases both the gross estate's total value and the estate tax liability after credits; it cannot be used merely for convenience or to selectively revalue only certain assets.

89. B — Under Section 2035, life insurance proceeds are pulled back into the gross estate if the decedent transferred an existing policy, or incidents of ownership in it, within three years before death. Because this transfer to the irrevocable trust occurred only twenty months before death, the three-year rule applies and the proceeds are includible, defeating the intended exclusion.

90. C — Section 642(g) prohibits a double deduction: administration expenses and casualty losses claimed on Form 706 cannot also be deducted on the estate's Form 1041. To shift the deduction to the income tax return, the executor must file a signed statement waiving the right to claim those expenses as estate tax deductions, effectively electing where the benefit applies.

91. A — When a closely held business interest exceeds 35% of the adjusted gross estate, Section 6166 allows the executor to elect to defer and pay the portion of estate tax attributable to that interest in up to ten annual installments after an initial deferral period, spanning up to fourteen years. Interest accrues on deferred tax, and certain events accelerate the balance.

92. D — A power exercisable in favor of the powerholder, her estate, her creditors, or the creditors of her estate is a general power of appointment. Under Section 2041, property subject to an unreleased general power the decedent held at death is includible in her gross estate, regardless of exercise, because she effectively had command over the property comparable to ownership.

93. C — A charitable lead trust reverses the payment structure of a charitable remainder trust: the charity receives the current income stream, here a fixed annuity, for the trust term, and the remainder passes to noncharitable beneficiaries. Depending on structure, the donor may claim an upfront charitable deduction while potentially reducing gift or estate tax on the value passing to the children.

94. D — Section 501(c)(3) organizations are absolutely prohibited from participating or intervening in any political campaign for or against a candidate for public office. Unlike lobbying, permitted up to certain limits and measurable under a Section 501(h) expenditure test, there is no insubstantial-activity safe harbor for campaign intervention; violation risks revocation of exempt status and excise taxes.

95. A — Public charities may make a Section 501(h) election to have lobbying measured under an objective expenditure test, with permitted lobbying calculated as a sliding-scale percentage of exempt purpose expenditures, subject to a dollar cap. This replaces the subjective 'no substantial part' standard with clearer, dollar-based limits, and exceeding them triggers an excise tax rather than automatic loss of exemption.

96. B — Under the mechanical public support test for Section 509(a)(1)/170(b)(1)(A)(vi) organizations, an organization qualifies as publicly supported if at least one-third of total support over the measuring period comes from governmental units, the general public, and other public charities. An organization between 10% and one-third may still qualify under a facts-and-circumstances test showing a bona fide fundraising program.

97. C — Section 4944 imposes an excise tax on investments that jeopardize a private foundation's ability to carry out its exempt purposes, judged by ordinary business care and prudence when made. Categories like speculative options trading, margin trading, and short sales draw close scrutiny. The initial tax falls on the foundation and, potentially, on managers who knowingly approved the investment.

98. B — Section 4945 imposes an excise tax on taxable expenditures, including grants to individuals for travel or study made without a pre-approved procedure, and grants to organizations that are not public charities made without exercising expenditure responsibility. Following IRS-approved individual grant procedures or documenting expenditure responsibility for the foreign grant avoids taxable expenditure treatment for each respective grant.

99. D — Converted amounts are not taxed again upon distribution, since tax was already paid at conversion, but each conversion has its own five-year clock. Withdrawing converted principal before that period ends, and before age 59½, generally triggers the 10% additional tax on early distributions unless an exception applies, even though the withdrawal itself is not includible in income again.

100. A — Net unrealized appreciation, or NUA, lets a participant receiving a qualifying lump-sum distribution of employer stock pay ordinary income tax only on the stock's cost basis at distribution, deferring tax on appreciation until sale, when taxed at capital gains rates. Rolling the stock into an IRA instead forfeits this benefit, since IRA withdrawals are taxed as ordinary income.