PRACTICE EXAM 19: 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. Under the Section 752 regulations, a partnership uses a hypothetical "constructive liquidation" to allocate recourse liabilities among partners. Which sequence of assumptions does this test apply to determine which partner bears the economic risk of loss?

A. The partnership sells all assets at fair market value, distributes proceeds equally, and liabilities are allocated by capital ratios
B. All partnership assets become worthless, all liabilities become due and payable in full, and the partnership disposes of every asset for no consideration
C. The partnership continues operating indefinitely, liabilities are refinanced annually, and no partner is treated as economically at risk
D. Each partner individually negotiates a separate release from the lender, and liabilities are allocated based on those negotiated releases

2. A partner who provides investment management services to a partnership waives her right to a stated annual management fee in exchange for an increased allocation of partnership profits that is calculated to closely track the fee she waived and is subject to little entrepreneurial risk. How does the IRS generally treat this arrangement under Section 707(a)(2)(A)?

A. As a disguised payment for services taxed as ordinary income, because the arrangement lacks meaningful entrepreneurial risk despite its form as a profits allocation

B. As a nontaxable distributive share of partnership profits, because any allocation labeled as a profits interest is respected regardless of its economic substance

C. As a tax-free contribution to partnership capital, because waived fees are treated the same as unpaid capital contributions under general partnership principles

D. As a guaranteed payment for capital, because waived management fees are always recharacterized as payments for the use of invested capital

3. Partnership Upper is itself a partner in Partnership Lower, forming a tiered structure. When Lower makes a cash distribution to Upper that exceeds Upper's basis in its Lower interest, what happens to Upper's outside basis in Lower, and what consequence follows?

A. Upper's basis in Lower becomes negative, and the excess is simply carried forward as a deferred basis adjustment with no gain recognized

B. Upper's basis in Lower is unaffected, because tiered partnerships are disregarded entirely and all basis is tracked solely at the lower-tier partner level

C. Upper's basis in Lower is increased by the excess distribution, and Upper recognizes a corresponding ordinary loss on its return for the year

D. Upper's basis in Lower is reduced to zero, and Upper recognizes gain under Section 731 to the extent the distribution exceeds that basis

4. A family partnership operates a consulting business in which capital is not a material income-producing factor; income is generated primarily through the personal services of the partners. A parent gifts a partnership interest to an adult child who performs some services but far less than the parent. How must partnership income be allocated to satisfy the family partnership rules?

A. Income must be allocated strictly according to each partner's percentage capital interest, regardless of the services each family member actually performs

B. Income may be allocated entirely to the child, since any completed gift of a partnership interest automatically validates the family partnership arrangement

C. Reasonable compensation must first be allocated for services actually rendered by each family member, with any remaining income divided according to ownership

D. Income must be allocated equally among all family members regardless of services performed, since capital is not a material income-producing factor here

5. A partnership does not maintain capital accounts or a liquidation-in-accordance-with-capital-accounts provision in its agreement, so it cannot satisfy the primary test for substantial economic effect. Under the alternative economic effect equivalence test, how may the partnership's allocations still be respected?

A. By showing that, as of each year's end, a hypothetical liquidation would produce the same economic results to partners as the primary capital-account test
B. By obtaining a private letter ruling from the IRS approving the allocations regardless of whether any economic consequences actually follow the allocations
C. By allocating all items equally among partners each year, since equal allocations are automatically deemed to satisfy the substantial economic effect requirement
D. By reallocating all prior-year items retroactively at the end of the partnership's existence, once the partners agree on a final liquidating distribution

6. A partnership distributes marketable securities to a partner in a nonliquidating distribution. The partner's outside basis is less than the fair market value of the securities received. Under Section 731(c), how are these marketable securities generally treated for purposes of determining whether the partner recognizes gain?

A. Marketable securities are always treated as ordinary income property under Section 751, regardless of the partner's outside basis or the securities' character
B. Marketable securities are excluded entirely from gain recognition analysis, since only cash distributions can ever trigger gain under the distribution rules
C. Marketable securities are treated as a tax-free return of capital in every case, so no gain is ever recognized on their distribution
D. Marketable securities are generally treated as money for purposes of Section 731, so gain is recognized to the extent value exceeds outside basis

7. The IRS completes an audit of a partnership's prior-year return under the BBA centralized audit regime and determines an imputed underpayment. Instead of the partnership itself paying the imputed underpayment, what alternative procedure allows the adjustment to be passed through to the reviewed-year partners?

A. The partnership representative unilaterally decides to ignore the adjustment, since imputed underpayments are only advisory and carry no binding payment obligation

B. The partnership makes a timely push-out election under Section 6226, issuing statements so reviewed-year partners report and pay their share of the adjustment

C. Each current partner automatically absorbs the entire adjustment through withholding, regardless of who held an interest during the year under examination

D. The partnership must dissolve entirely before any imputed underpayment can be shifted away from payment at the entity level under this regime

8. A partnership allocation has formal economic effect because it properly maintains capital accounts and liquidates according to them, but the allocation shifts tax consequences among partners from one year to the next without substantially affecting the dollar amounts each partner actually receives. How does the substantiality requirement treat this type of allocation?

A. Substantiality is irrelevant once economic effect is established, so any allocation with proper capital accounts is automatically respected for tax purposes

B. The allocation is respected because substantiality only applies to allocations of nonrecourse deductions, never to allocations involving recourse items or timing shifts

C. The allocation fails the substantiality requirement because it is a shifting or transitory allocation designed mainly to reduce partners' aggregate tax liability

D. The allocation automatically satisfies substantiality because formal economic effect and substantiality are legally identical requirements under the regulations in every case

9. A sole proprietor's nonfarm business generates net profit that is low relative to prior years, and her net earnings from self-employment are less than two-thirds of her average gross nonfarm income and below the applicable threshold. Which technique may allow her to report higher net earnings for self-employment tax purposes despite the low actual profit?

A. She must amend prior returns to average her nonfarm income upward before any optional reporting method becomes available for the current year

B. She may deduct additional business expenses retroactively to reduce net profit further, which is the only IRS-approved way to adjust reported earnings

C. She may elect the nonfarm optional method, reporting a set percentage of two-thirds of gross nonfarm income, subject to statutory dollar limits

D. She must report zero net earnings from self-employment for the year, since low-profit years are automatically excluded from self-employment tax entirely

10. An individual holds a state-law limited partnership interest but works full-time managing the partnership's operations and actively participates in day-to-day decisions, unlike a passive investor. Recent case law and IRS scrutiny of the Section 1402(a)(13) limited partner exception to self-employment tax generally focus on which factor in determining whether the exception applies?

A. The state-law label on the partnership agreement alone, since courts treat the formal designation as conclusively determinative regardless of the partner's actual role
B. The partner's citizenship status, since only nonresident partners may ever qualify for the limited partner exception under recent judicial interpretations of the statute
C. The size of the partner's capital contribution alone, since larger contributions automatically disqualify a partner from claiming the limited partner exception
D. The partner's functional role in the business, since courts have looked past the state-law label to actual participation, management, and services performed

11. An existing partnership admits a new partner for a cash contribution and, under its capital account maintenance provisions, revalues (books up) its existing property to reflect current fair market value at that time. How are subsequent tax allocations of built-in gain or loss in the revalued property generally handled for the existing partners?

A. Reverse Section 704(c) principles never apply to revaluations, so all built-in gain or loss is simply ignored for tax allocation purposes going forward
B. Reverse Section 704(c) principles apply, allocating the pre-revaluation built-in gain or loss to the existing partners much like original contributed built-in gain
C. The new partner alone absorbs all built-in gain or loss from the revaluation, since only incoming partners bear responsibility for prior appreciation
D. The partnership must liquidate and reform entirely before any built-in gain or loss from a capital account revaluation can be allocated to any partner

12. A partnership makes a single nonliquidating distribution to a partner consisting of both inventory and a parcel of land, with the partner's outside basis lower than the partnership's combined inside basis in both properties. Under Section 732(c), in what order is the partner's limited outside basis allocated among the distributed properties?

A. Basis is first assigned to unrealized receivables and inventory items up to their inside basis, then any remaining basis is allocated to other property

B. Basis is allocated strictly according to the relative fair market values of all distributed properties, without regard to inventory or receivables status

C. Basis is allocated entirely to the land first, since real property is always given allocation priority over inventory under the distribution rules

D. Basis is allocated equally between the two properties regardless of type, fair market value, or the partnership's inside basis in each asset

13. A sole proprietor also earns wages from a separate employer during the year, and those wages are subject to Social Security (OASDI) tax withholding. When she computes the OASDI portion of her self-employment tax under Section 1402(b), how does her wage income affect the calculation?

A. The OASDI wage base for self-employment tax purposes is reduced by the wages already subject to Social Security tax, limiting the base to the remaining ceiling

B. Her wage income has no effect whatsoever on either portion of her self-employment tax, since the two tax systems are calculated in total isolation

C. Her self-employment income is entirely exempt from the OASDI portion whenever she also receives any wages from a separate unrelated employer

D. Her wages are added directly to net earnings from self-employment, and both amounts are separately subjected to the full uncapped OASDI tax rate

14. A partner sells her entire partnership interest for a gain. After accounting for the ordinary income portion attributable to unrealized receivables and substantially appreciated inventory under Section 751, the remaining capital gain reflects the partnership's underlying assets, which include antique collectibles and depreciable real property with prior straight-line depreciation. How is this remaining capital gain generally characterized?

A. The entire remaining gain is taxed at the standard long-term capital gain rate, since look-through rules apply only to the Section 751 ordinary income portion

B. The entire remaining gain is automatically converted to ordinary income once any portion of the partnership's assets includes depreciable real property or collectibles

C. Look-through rules apply so the gain includes 28% rate gain from collectibles and unrecaptured Section 1250 gain, taxed accordingly instead of one flat rate

D. The remaining gain is entirely exempt from tax, since only the Section 751 ordinary income component of a partnership interest sale is ever taxable

15. A partner sells 70% of the total interests in partnership capital and profits to unrelated buyers within a twelve-month period. Under prior law before 2018, this sale could cause a technical termination of the partnership. Under current law, what is the effect of this same sale on the partnership's continued existence for tax purposes?

A. The sale still automatically causes a technical termination, requiring the partnership to close its books and file a final short-year return immediately

B. The sale causes termination only if the buyers are related parties, since unrelated-party sales were never subject to the technical termination rule

C. The sale causes termination only if it occurs across two separate partnership tax years rather than within a single twelve-month measuring period

D. The sale no longer causes termination, since the technical termination rule based solely on a 50%-or-more sale of interests was repealed for years after 2017

16. A limited partner's amount at risk in a partnership activity is reduced below zero during the year because of distributions and allocated losses that exceed her remaining at-risk basis from prior years. Under Section 465(e), what generally happens when a partner's at-risk amount goes negative?

A. Nothing happens currently, because negative at-risk amounts are simply carried forward indefinitely with no income recapture required in any circumstance

B. The partner must recapture as income the amount by which prior deductions exceed her at-risk amount, to the extent previously allowed losses exceed it

C. The partnership itself, rather than the partner, must recognize ordinary income equal to the entire negative at-risk amount on its own return

D. The negative amount is automatically converted into additional partnership debt, permanently increasing the partner's outside basis without any income recognition required

17. A partnership made a valid Section 754 election in a prior tax year and now wants to stop applying basis adjustments to future transactions, believing the adjustments have become administratively burdensome. What must the partnership generally do to revoke its existing Section 754 election?

A. Nothing; a Section 754 election automatically expires after five tax years and never requires any further action from the partnership to end it

B. The partnership may simply stop reporting basis adjustments on future returns, since no formal revocation procedure or approval is required under the regulations

C. Only a unanimous vote of all current partners is needed, with no requirement to notify or seek approval from the IRS at all

D. The partnership must file a request with the IRS and obtain the Commissioner's consent, showing a change in circumstances, to revoke the election

18. A sole proprietor claimed a Section 179 deduction on equipment used more than 50% for business in the year placed in service. In a later year, business use of that equipment drops to 40%. What is the general tax consequence of this drop in business use?

A. There is no consequence at all, since Section 179 deductions are never subject to recapture once properly claimed in the year of purchase

B. The equipment must be immediately scrapped or sold, since Section 179 property automatically ceases to be depreciable once business use falls below 50%

C. The proprietor must recapture as ordinary income the excess of the Section 179 deduction over the depreciation that would have been allowed otherwise

D. The proprietor may claim an additional Section 179 deduction in the drop-off year to offset the reduced business-use percentage on the same asset

19. In connection with an otherwise qualifying Section 351 transfer of property to a controlled corporation, a transferor receives "nonqualified preferred stock," as defined in Section 351(g), rather than common stock. How is the receipt of this stock generally treated for purposes of the nonrecognition rule?

A. It is treated identically to common stock, and its receipt causes no gain recognition whatsoever under Section 351.

B. It is treated as boot rather than stock under Section 351, triggering gain recognition to the extent of its value.

C. It automatically disqualifies the entire exchange from any Section 351 nonrecognition treatment for every transferor involved.

D. It is treated as a tax-exempt security, permanently deferring all gain recognition until the corporation eventually liquidates.

20. A corporate shareholder receives an extraordinary dividend from a corporation in which it has held stock for less than two years, and the shareholder claims a dividends-received deduction on that dividend. Under Section 1059, what happens to the shareholder's stock basis?

A. The shareholder must reduce its stock basis by the nontaxed portion of the extraordinary dividend, recognizing gain if the reduction exceeds basis.
B. The shareholder's stock basis increases automatically by the full amount of the dividend received, regardless of any deduction claimed.
C. The shareholder's stock basis remains completely unaffected, since dividends received deductions never interact with basis under any Code section.
D. The shareholder must permanently suspend the dividends-received deduction itself until the stock is eventually sold at a gain.

21. In evaluating whether an otherwise qualifying Section 355 spinoff is being used principally as a "device" for the distribution of earnings and profits, which factor is most indicative of device rather than a legitimate business purpose?

A. Both the distributing and controlled corporations continue actively conducting the same trade or business they conducted for five years before the distribution.
B. The distribution is pro rata among shareholders but is followed by years of continued active operation with no stock sales.
C. The distribution is preceded by a clear, well-documented corporate business purpose unrelated to any shareholder-level tax planning motive.
D. The distribution is pro rata, and shortly afterward the shareholders sell or exchange the stock of either corporation for cash.

22. A C corporation sells depreciable real property and recognizes gain that would be Section 1250 ordinary income recapture if it were computed using the corporate preference item rules of Section 291. Under Section 291, how does this provision generally affect the corporation's recapture computation?

A. Section 291 eliminates Section 1250 recapture entirely for corporate taxpayers, converting the full gain into long-term capital gain.

B. Section 291 doubles the applicable Section 1250 recapture percentage, treating the entire gain as ordinary income for corporations.

C. Section 291 requires an additional 20% of the excess that would have been Section 1245 recapture to be treated as ordinary income.

D. Section 291 applies only to S corporations and has no effect whatsoever on any C corporation's recapture computation.

23. Corporation X and Corporation Y are members of the same controlled group under Section 267(f). Corporation X sells depreciable equipment to Corporation Y at a loss. Under the Section 267(f) intercompany loss deferral rule, when may Corporation X generally take that loss into account?

A. The loss is deferred and generally recognized only when the property is later transferred outside the controlled group in a recognition event.

B. The loss is disallowed permanently in full, with no possibility of ever being recognized by any member of the group.

C. The loss is recognized immediately in full on Corporation X's return, exactly as it would be between unrelated parties.

D. The loss is recognized immediately but only up to fifty percent of its amount, with the remainder permanently disallowed.

24. A shareholder of an S corporation dies, and under the terms of her will, her stock passes into a testamentary trust that is not a QSST or an ESBT. Under Section 1361(c)(2), for how long may this testamentary trust hold the stock and still count as a permitted S corporation shareholder?

A. Indefinitely, provided the trust files its own separate S election within ninety days of receiving the stock from the estate.

B. For a period of two years beginning on the date the stock is transferred to the trust, without any special election required.

C. Only until the end of the decedent's final individual tax year, after which the trust must immediately liquidate its holding.

D. For six months only, matching the automatic extension period generally available for filing the decedent's final income tax return.

25. A corporation understates its tax liability on a filed return by an amount that meets the corporate substantial understatement threshold under Section 6662. Absent reasonable cause or an applicable exception, what accuracy-related penalty rate generally applies to the resulting understatement?

A. A 20% penalty applies to the portion of the underpayment attributable to the substantial understatement of income tax.
B. A 75% penalty applies automatically, identical to the civil fraud penalty rate regardless of whether fraud is shown.
C. No penalty applies to corporations at all, since Section 6662 is limited by its terms to individual taxpayers only.
D. A flat 100% penalty applies, matching the trust fund recovery penalty rate imposed under an entirely different Code section.

26. A publicly held corporation makes a compensatory payment to a disqualified individual that is contingent on a change in corporate control and that equals or exceeds three times the individual's base amount compensation. Under Section 280G, how is the excess parachute payment generally treated?

A. The excess amount is fully deductible by the corporation and is treated as ordinary wage income to the recipient only.
B. The excess amount is nondeductible by the corporation, and the recipient is subject to a 20% nondeductible excise tax on it.
C. The excess amount is entirely tax-exempt to the recipient, since change-in-control payments are excluded from gross income by statute.
D. The excess amount must be repaid to the corporation within one year or the entire change-in-control transaction is voided retroactively.

27. A domestic corporate seller disposes of all of its stock in a subsidiary in a taxable sale, and no purchasing corporation joins in a Section 338(h)(10) election. The seller and target instead jointly make a Section 336(e) election. What is the primary effect of this election?

A. The stock sale is recharacterized as a tax-free reorganization, allowing both parties to defer all gain indefinitely under Section 368.
B. The election converts the transaction into a Section 351 exchange, giving the purchaser carryover basis in the target's assets acquired.

C. The target is treated as selling all its assets in a deemed asset sale, and the stock sale itself is disregarded for tax purposes.
D. The election has no substantive tax effect at all and exists solely as an informational filing requirement with no consequences.

28. Acquiring Corp forms a wholly owned merger subsidiary, which then merges into Target Corp, with Target surviving as Acquiring's subsidiary and Target's former shareholders receiving solely Acquiring voting stock. For this reverse triangular merger to qualify under Section 368(a)(2)(E), which requirement must generally be satisfied?

A. Target must distribute substantially all of its historic assets to its former shareholders immediately following completion of the merger.
B. The merger subsidiary must remain in existence as a separate operating entity conducting business alongside Target after the merger closes.
C. Target's former shareholders must receive at least fifty percent cash consideration to satisfy the continuity of interest requirement.
D. Target must hold substantially all of its own and the merger subsidiary's former assets, with Acquiring obtaining control through voting stock.

29. A corporation joins an existing consolidated group after having generated net operating losses while it was a separate, nonmember taxpayer in prior years. Under the separate return limitation year (SRLY) rules, how may those pre-affiliation losses generally be used against the group's consolidated income?

A. The pre-affiliation losses may offset the full consolidated taxable income of every member of the group without any restriction.
B. The pre-affiliation losses are permanently forfeited in full immediately upon the corporation joining the consolidated group.
C. The pre-affiliation losses are generally limited to offsetting only the joining member's own contribution to consolidated taxable income.
D. The pre-affiliation losses convert automatically into general business credits usable by any member of the consolidated group.

30. A closely held C corporation that is not a personal service corporation generates losses from a rental real estate activity in which its shareholder-officers do not materially participate. Under the modified passive activity loss rules of Section 469 applicable to closely held C corporations, how may these losses generally be used?

A. The losses are fully passive and cannot offset any income at all, identical to the treatment for individual taxpayers.
B. The losses may offset the corporation's net active business income, though not its portfolio income, under the closely held modification.
C. The losses may freely offset both active business income and portfolio income without any limitation whatsoever for closely held corporations.
D. The losses are automatically recharacterized as ordinary business deductions with no passive activity limitation applying to any C corporation.

31. A single common parent corporation owns at least 80% of the vote and value of three separate subsidiary corporations, but the subsidiaries themselves have no direct ownership interest in one another. Under Section 1563, how is this group of four corporations generally classified?

A. It is not treated as any controlled group, since Section 1563 requires at least one subsidiary to own stock in another subsidiary.
B. It is treated as a brother-sister controlled group, since ownership is concentrated among a small number of common individual owners.
C. It is treated as an unrelated collection of corporations for all federal controlled group purposes under Section 1563.
D. It is treated as a parent-subsidiary controlled group under Section 1563(a)(1), with the common parent as the group's head.

32. A minority shareholder's percentage stock ownership, voting power, and right to participate in corporate management are all meaningfully reduced, though not eliminated, by a corporate redemption of a portion of her shares. The redemption fails the mechanical safe harbors of Section 302(b)(2) and (b)(3). Under Section 302(b)(1), how might the redemption still be treated?

A. It may still qualify for exchange treatment if it results in a meaningful reduction of the shareholder's proportionate interest in the corporation.
B. It automatically fails exchange treatment because only the mechanical safe harbors of Section 302(b) may ever produce sale or exchange treatment.

C. It automatically qualifies for exchange treatment regardless of the facts, simply because some reduction in ownership occurred at all.
D. It is recharacterized as a Section 351 contribution, deferring all recognition until the shareholder later disposes of her remaining stock.

33. An S corporation's election terminates mid-year on a date other than the first day of its tax year, creating a short S corporation year and a short C corporation year within the same calendar year. Absent a closing-of-the-books election, how are the corporation's items of income and loss generally allocated between the two short years?

A. All income and loss for the year is assigned to the short C corporation year, with nothing allocated to the S short year.
B. Items are allocated on a pro rata daily basis between the two short years according to the number of days in each period.
C. Items are allocated entirely to the short S corporation year, leaving the short C corporation year with no reportable income at all.
D. Items are allocated based on shareholder votes taken at a special meeting called immediately after the termination event.

34. Two corporations, Member A and Member B, are includible members of the same consolidated group and file a consolidated return. Member A sells inventory to Member B at a gain during the year, and Member B still holds that inventory unsold to a party outside the group at year-end. Under the consolidated return intercompany transaction rules, how is Member A's gain generally treated?

A. The gain is recognized immediately in full on the consolidated return, exactly as if the sale had occurred between unrelated parties.
B. The gain is permanently excluded from the consolidated group's income and is never recognized by any member under any circumstances.
C. The gain is generally deferred and recognized later, typically when a triggering event such as a resale outside the group occurs.
D. The gain is immediately converted into a capital loss carryforward available to offset unrelated future consolidated capital gains only.

35. An eligible individual is the sole owner of a single-member LLC that has made no entity classification election and is therefore a disregarded entity for federal tax purposes. This LLC directly holds stock in a corporation that has elected S status. For purposes of the S corporation eligible shareholder rules, how is this ownership generally treated?

A. The stock ownership disqualifies the S election immediately, because any LLC holding S corporation stock is automatically treated as an ineligible entity shareholder.
B. The LLC is treated as a partnership for this purpose, and its single-member status is disregarded entirely, disqualifying the election outright.
C. The stock ownership is permitted only if the LLC first converts into a qualified subchapter S trust before the election takes effect.
D. The LLC is disregarded, and the individual owner is treated as directly holding the stock, so the S election remains valid.

36. An accrual-method business is contractually obligated to provide consulting services to a client over the next year and accrues a liability related to that future performance. Under the general rule of IRC Section 461(h)(2)(A) for liabilities requiring the taxpayer to provide services to another party, when does economic performance occur?

A. As the business actually performs and renders the services to the other party
B. When the client signs the contract obligating future services
C. When the business books the liability on its year-end financial statements
D. When the client prepays for the services in advance

37. A securities dealer maintains two categories of securities: inventory held for sale to customers in the ordinary course of the dealer business, and a separate portfolio properly identified under Section 1236 as held for investment. She sells investment-portfolio securities at a loss and repurchases substantially identical securities within 30 days, and separately sells ordinary trading inventory securities at a loss and replaces them shortly after. How does the wash sale rule under Section 1091 treat these two losses?

A. The wash sale rule disallows the loss on the ordinary dealer inventory but not the investment-portfolio loss
B. The wash sale rule disallows neither loss because the taxpayer is a securities dealer
C. The wash sale rule disallows the loss on the investment-portfolio securities but not the ordinary dealer inventory loss
D. The wash sale rule disallows both losses because both involve stock transactions

38. A cash-method sole proprietor performs services for a client and, instead of cash, receives the client's promissory note that is unsecured, carries no assurance of collectibility, and is not readily marketable or discountable to third parties. Under the cash equivalency doctrine, how does the proprietor generally treat receipt of this note?

A. Income is recognized immediately at the note's stated face value because any note received for services is cash equivalent

B. Income is recognized immediately at the note's fair market value discounted for the taxpayer's own credit risk

C. Income recognition is deferred until the note is formally endorsed over to a third-party lender

D. Income is not recognized until payments are actually collected because the note is not readily convertible to cash

39. A manufacturing business voluntarily remediates soil contamination on land it owns and actively uses in its trade or business, restoring the land to its condition before the contamination occurred without creating any improvement beyond that original state. How are the environmental remediation costs generally treated for tax purposes?

A. The costs must be capitalized to the land under Section 263 as a permanent improvement

B. The costs are generally currently deductible as ordinary and necessary business expenses under established IRS guidance

C. The costs must be capitalized and amortized ratably over a fixed fifteen-year recovery period

D. The costs are nondeductible because environmental cleanup is treated as a personal expenditure

40. A corporation facing multiple lawsuits arranges for a court-approved fund meeting the requirements of Section 468B to receive and hold settlement money pending final resolution and distribution to claimants. What is the primary tax advantage of using this qualified settlement fund structure for the paying corporation?

A. The corporation may claim an economic performance deduction upon transferring funds into the qualified settlement fund, before claimants are actually paid

B. The corporation permanently avoids any income tax liability on amounts transferred into the fund

C. The qualified settlement fund itself is entirely exempt from federal income tax on any income it earns

D. The corporation may defer recognizing the underlying liability indefinitely until the statute of limitations expires

41. A timber owner has a depletion basis in standing timber of $180,000 and an estimated 90,000 board feet of recoverable timber. During the current year, the owner cuts and sells 15,000 board feet. Applying cost depletion using the unit method, what is the allowable depletion deduction for the year?

A. $18,000
B. $30,000
C. $45,000
D. $60,000

42. A business deducted a $15,000 bad debt expense in a prior year and received a full tax benefit from that deduction. In the current year, the business unexpectedly recovers $9,000 of the previously written-off debt. Under the tax benefit rule, how is the $9,000 recovery treated in the current year?

A. The $9,000 is included in current-year gross income to the extent the prior deduction produced a tax benefit
B. The $9,000 is treated as a nontaxable return of capital because it merely restores a previously deducted amount
C. The $9,000 must be used to amend the prior year's return and reduce the original bad debt deduction
D. The $9,000 is excluded from income entirely because bad debt recoveries are never taxable

43. A business sells equipment to another business under a deferred payment contract due in eighteen months, with no interest stated in the agreement, at a stated sale price. The transaction is not otherwise governed by the original issue discount rules. Under IRC Section 483, how is this transaction generally treated for tax purposes?

A. No interest is imputed because the parties are free to structure a sale price without stated interest
B. The entire stated sale price is treated as ordinary interest income to the seller in the year of sale
C. Part of the stated sale price is recharacterized as unstated interest, taxed as ordinary income to the seller over the deferral period

D. The buyer, not the seller, bears sole responsibility for imputing and reporting interest income on the transaction

44. A cash-method farmer's crops are damaged by a natural disaster during the current year, and the farmer receives crop insurance proceeds compensating for the resulting crop loss in that same year. Under Section 451(d), what election is available regarding the tax year in which these proceeds are reported?

A. The farmer must always report the proceeds in the year of damage, regardless of when payment is actually received

B. The farmer may permanently exclude the proceeds from gross income whenever replacement crops are planted the next season

C. The farmer must amortize and report the proceeds ratably in equal installments over the following three tax years

D. The farmer may elect to defer the proceeds to the following year by showing crop income would normally have been reported then

45. A business incurs $120,000 of domestic research and experimental expenditures during the current tax year. Under IRC Section 174 as amended, effective for amounts paid or incurred in tax years beginning after December 31, 2021, how must the business generally treat these costs?

A. The costs must be capitalized and amortized ratably over a five-year period for domestic research, using a mid-year convention

B. The costs remain fully deductible in the year paid or incurred, as under prior law

C. The costs must be capitalized and amortized ratably over a fixed three-year period regardless of where the research occurs

D. The costs must be added to the basis of any resulting patent and recovered only upon the patent's sale or abandonment

46. A corporation subject to the Section 163(j) business interest expense limitation has adjusted taxable income of $500,000 for the year and no floor-plan financing interest or business interest income. Ignoring any carryforward of disallowed interest from prior years, what is the maximum business interest expense the corporation may generally deduct in the current year?

A. $100,000, equal to 20% of adjusted taxable income
B. $150,000, equal to 30% of adjusted taxable income
C. $250,000, equal to 50% of adjusted taxable income
D. $500,000, with no percentage limitation applied

47. A self-employed consultant takes a client to a restaurant to discuss an active business engagement and separately purchases tickets to a sporting event to entertain the same client afterward. How are these two categories of expense generally treated under current tax law?

A. Both the restaurant meal and the sporting event tickets are fully deductible as ordinary business expenses
B. Both the restaurant meal and the sporting event tickets are entirely nondeductible personal expenses
C. The restaurant meal is generally 50% deductible, while the entertainment ticket cost is generally nondeductible
D. The restaurant meal is entirely nondeductible, while the entertainment ticket cost is generally 50% deductible

48. A contractor uses the completed contract method to account for a long-term construction contract that qualifies for the method. Under this method, when does the contractor generally recognize the gross income and related costs from the contract?

A. Ratably over the contract term based on the percentage of estimated total costs incurred each year
B. In the year the contract is signed, based on the total estimated contract price
C. Annually, using the look-back method to true up prior-year income estimates
D. In the tax year the contract is completed and accepted, when all income and allocable costs are reported together

49. An accrual-method business is contractually obligated to pay a rebate to customers based on their purchase volume for the year. Under the specific economic performance rule for liabilities requiring the taxpayer to pay a rebate, refund, or similar payment to another party, when does economic performance generally occur?

A. When the business enters into the rebate agreement with its customers

B. When the business actually makes payment of the rebate to the customer

C. When the business's books reflect an estimate of the rebate liability at year-end

D. When the customer's purchases first reach the volume threshold triggering eligibility

50. A calendar-year C corporation generates a net operating loss in a tax year beginning after December 31, 2017, and carries the loss forward to a later profitable year. Under current law, what limitation applies to the corporation's use of this NOL carryforward against taxable income in the later year?

A. The NOL deduction generally cannot exceed 80% of taxable income for the year, computed before the NOL deduction

B. The NOL deduction is limited to 50% of taxable income for the year, computed after the NOL deduction

C. The NOL deduction may offset 100% of taxable income with no percentage limitation, as under prior law

D. The NOL carryforward expires after twenty years and may not be used in any later year beyond that period

51. A taxpayer operates two separate sole proprietorships during the year: Business A generates $55,000 of net profit, and Business B generates a $15,000 net loss. The taxpayer also earns $40,000 of W-2 wages from an unrelated employer. The taxpayer purchased $75,000 of qualifying Section 179 property for Business A. For purposes of the Section 179 taxable income limitation, what amount of aggregate business income supports the deduction?

A. $55,000, since only Business A's own net profit counts toward the taxable income limitation

B. $40,000, since only the W-2 wages count toward the taxable income limitation for a sole proprietor

C. $80,000, since the limitation aggregates net income and losses from every business, plus wages earned as an employee

D. $95,000, since the limitation ignores losses from any business not itself claiming the Section 179 deduction

52. A calendar-year business acquired and placed in service new qualified machinery on March 1, 2025, after enactment of the 2025 tax legislation informally called the One Big Beautiful Bill Act. Under this legislation, what first-year bonus depreciation percentage generally applies to this property, compared to the phase-down rate that would have applied under prior law?

A. 40%, the phase-down rate that would have applied to property placed in service in 2025 under prior law

B. 60%, the phase-down rate that applied to property placed in service during the 2024 calendar year

C. 80%, the phase-down rate that applied to property placed in service during the 2023 calendar year

D. 100%, because the legislation permanently restored full bonus depreciation for property acquired after January 19, 2025

53. A business purchases a new sport utility vehicle with a gross vehicle weight rating of 6,500 pounds, used 100% for business, and also purchases a heavy pickup truck exceeding 6,000 pounds with a cargo bed and no passenger seating behind the driver, also used 100% for business. How does Section 179 treat the SUV differently from the pickup truck?

A. The SUV is entirely ineligible for Section 179, while the pickup truck may be expensed with no limitation

B. Both vehicles face identical Section 179 dollar caps, since both exceed 6,000 pounds of gross vehicle weight

C. The SUV's Section 179 deduction is capped at a separate, lower indexed dollar limit that the open-bed pickup truck generally avoids

D. The pickup truck is subject to the SUV dollar cap, while the SUV may be expensed with no dollar limitation

54. A taxpayer owns three separate trades or businesses and wants to aggregate them for purposes of computing the QBI deduction, combining wage and UBIA limitations across the group. Under the QBI aggregation regulations, which of the following is one of the required common-ownership factors the taxpayer must satisfy?

A. The same person or group of persons must own 50% or more of each business, measured by vote or value or by capital or profits

B. Each business must independently generate at least $100,000 of qualified business income before any aggregation is ever permitted

C. All three businesses must be operated through the identical legal entity type, such as three commonly owned S corporations

D. The taxpayer must obtain advance IRS consent through a private letter ruling before aggregating any trades or businesses

55. A U.S. business owns specialized manufacturing equipment that is used predominantly outside the United States throughout the tax year. Which depreciation system must the business use to recover the cost of this equipment?

A. Regular MACRS under the General Depreciation System, applying the same recovery periods used for identical domestic equipment
B. Section 179 expensing exclusively, because property used outside the United States is ineligible for any other method
C. Straight-line depreciation over an arbitrary useful life selected by the taxpayer, since no statutory recovery period applies
D. The Alternative Depreciation System, which is mandatory for tangible property used predominantly outside the United States

56. A developer receives a 9% low-income housing tax credit allocation for new construction that is not federally subsidized. Over what period is this credit generally claimed, and what happens if the property fails to remain qualified throughout the full compliance period?

A. The credit is claimed entirely in the placed-in-service year, and no recapture ever applies regardless of later noncompliance
B. The credit is claimed ratably over a 10-year credit period, but recapture may apply if the 15-year compliance period is not maintained
C. The credit is claimed over a 15-year credit period, with recapture limited strictly to the final compliance year only
D. The credit is claimed over a 5-year credit period matching the rehabilitation credit, with no separate compliance requirement

57. A corporation is deciding between the regular (traditional) credit method and the Alternative Simplified Credit (ASC) method for computing its Section 41 research credit. Which statement correctly contrasts the two computation approaches?

A. Both methods apply an identical 20% rate to research expenses exceeding the same historical fixed-base percentage threshold each year

B. The traditional method actually uses a flat 14% rate, while the ASC method instead requires a historical fixed-base percentage

C. The ASC method entirely disallows any credit unless the corporation had qualified research expenses in each of the prior three years

D. The traditional method applies 20% to expenses exceeding a fixed-base-percentage base, while the ASC applies 14% to expenses exceeding half the three-year average

58. A taxpayer sells nonresidential real property held for eight years, on which straight-line MACRS depreciation was used throughout, producing a $60,000 gain entirely attributable to depreciation previously claimed (unrecaptured Section 1250 gain). At what maximum federal rate is this specific gain generally taxed?

A. 25%, the special maximum rate applicable to unrecaptured Section 1250 gain regardless of the taxpayer's ordinary bracket

B. 37%, the taxpayer's highest ordinary income tax bracket, because straight-line depreciation triggers full ordinary recapture

C. 15%, the standard long-term capital gain rate that applies to all real property depreciation recapture

D. 20%, the highest standard long-term capital gain rate, with no special rate for depreciation-related real property gain

59. How does the general business credit's statutory limitation generally interact with a taxpayer's tentative minimum tax when determining how much credit may be used in the current year?

A. The credit is limited only by net income tax, and tentative minimum tax has no bearing on the computation

B. Tentative minimum tax completely eliminates any general business credit usage until all AMT liability is paid in full

C. The credit generally cannot reduce tax below the greater of tentative minimum tax or 25% of net regular tax liability over $25,000

D. Tentative minimum tax doubles the allowable general business credit for taxpayers subject to alternative minimum tax this year

60. In addition to the base small employer retirement plan startup cost credit, an eligible employer that adds an automatic enrollment feature to its new qualified plan may claim what additional benefit under Section 45E?

A. An automatic doubling of the base startup credit percentage for every year the automatic enrollment feature remains active

B. A separate flat-dollar credit, generally up to $500 per year for three years, for including an automatic enrollment feature

C. A permanent exemption from the plan's minimum coverage and nondiscrimination testing requirements for all future plan years

D. A one-time refundable credit equal to the total account balances of all employees automatically enrolled in the plan

61. A commercial building owner engages a qualified cost segregation study following new construction. The study reclassifies certain electrical and plumbing components dedicated to specific equipment, decorative finishes, and site improvements from 39-year nonresidential real property into shorter MACRS recovery classes. What is the general tax effect of this reclassification?

A. It eliminates all future depreciation deductions on the reclassified components, since they are treated as immediately worthless

B. It accelerates depreciation by assigning components to 5-, 7-, or 15-year classes, which may also qualify for bonus depreciation

C. It converts the entire building, including structural elements, into 5-year property eligible for full first-year expensing

D. It has no effect on depreciation timing but permanently increases the building's overall depreciable basis for tax purposes

62. A single taxpayer's taxable income is $25,000 above the QBI threshold amount, falling within the applicable $50,000 phase-in range for a specified service trade or business. What percentage of the SSTB's QBI, W-2 wages, and UBIA of qualified property is taken into account before applying the wage and UBIA limitation?

A. 100%, because the SSTB exclusion does not begin applying until taxable income exceeds the full phase-in range entirely

B. 0%, because any taxable income above the threshold amount fully disqualifies an SSTB from any QBI benefit

C. 75%, because the phase-in reduction is calculated using the threshold amount rather than the applicable range

D. 50%, because the taxpayer is halfway through the phase-in range, so only half of QBI, wages, and UBIA are counted

63. Two corporations that are members of the same controlled group under Section 179(d)(6) each purchase qualifying equipment during the same tax year. How is the Section 179 dollar limitation generally applied between the two members?

A. Each member independently receives the full statutory dollar limitation, with no aggregation required across the controlled group
B. Only the parent corporation in the controlled group may claim any Section 179 deduction for the entire group
C. The controlled group is treated as a single taxpayer for the dollar limitation, apportioned among members by agreement or statutory default
D. The dollar limitation is doubled for controlled groups to account for the combined equipment purchases of both members

64. A newly formed C corporation incurs $8,000 of organizational expenditures, such as legal fees for drafting the corporate charter and fees for the first meeting of directors, before beginning business. Under Section 248, how are these costs generally treated?

A. $5,000 is immediately deductible, with the remaining $3,000 amortized ratably over 180 months, similar to Section 195 start-up costs
B. The full $8,000 is immediately deductible in the year the corporation begins business, with no amortization requirement at all
C. The full $8,000 must be capitalized indefinitely and cannot be recovered until the corporation is completely liquidated
D. The costs are deducted entirely on the shareholders' individual returns rather than on the corporation's own tax return

65. A taxpayer computes percentage depletion for an oil and gas property, and the computed amount would exceed 65% of the taxpayer's taxable income from all sources, calculated before the depletion deduction. What is the effect of this limitation?

A. Percentage depletion is entirely disallowed for the year, and the taxpayer must instead switch permanently to cost depletion

B. Percentage depletion is capped at 65% of taxable income before depletion, with the disallowed excess carried forward to later years

C. Percentage depletion is capped at 65% of gross income from the property, with no carryover of any disallowed excess

D. Percentage depletion is unaffected by any taxable income limitation, since only cost depletion is subject to such a cap

66. A business has consistently treated a class of workers as independent contractors, filed all required Forms 1099-NEC consistent with that treatment, and had a reasonable basis for the classification based on long-standing industry practice. Under Section 530 of the Revenue Act of 1978, what is the effect of this relief if the IRS later audits the business?

A. The IRS may reclassify the workers as employees but must waive any resulting late-filing penalties for original Form 1099-NEC filings

B. The business must still pay all back payroll taxes but may deduct them as an ordinary business expense in the year assessed

C. The IRS is prohibited from retroactively reclassifying the workers as employees for federal employment tax purposes for the periods covered

D. The business may keep its independent contractor treatment only if it also obtains a favorable determination letter from the IRS

67. An employee holds two concurrent part-time jobs and wants her Form W-4 withholding to account for the combined income from both positions so that neither employer under-withholds. Which approach does the IRS specifically build into Form W-4 to address this multiple-jobs situation?

A. Using the Form W-4 Step 2 multiple jobs worksheet or the IRS Tax Withholding Estimator to compute an additional withholding amount

B. Filing a separate Form W-4 with each employer claiming exempt status until the combined annual income is finally determined

C. Requesting that one employer withhold at the highest marginal bracket while the other employer withholds nothing for the entire year

D. Submitting Form W-4V to each employer so that a flat 10 percent voluntary withholding rate applies to both paychecks

68. An employer occasionally provides employees with small-value items such as holiday turkeys, occasional coffee and snacks, and infrequent personal use of the company photocopier. Under Section 132(e), how are these benefits generally treated for federal employment tax purposes?

A. Fully taxable as wages subject to income tax withholding, Social Security, and Medicare tax because no dollar threshold is specified
B. Excludable only if the employer maintains a written accountable plan requiring employees to substantiate the value of each item received
C. Taxable to the extent the cumulative value exceeds $600 per employee for the calendar year, similar to Form 1099-NEC reporting
D. Excludable from wages as de minimis fringe benefits because their value and frequency make accounting for them unreasonable or impractical

69. A very small employer with an estimated annual employment tax liability of $800 receives written notification from the IRS that it qualifies to file its employment tax return annually rather than quarterly. Which form does this employer file instead of Form 941?

A. Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, filed in place of all quarterly payroll tax obligations
B. Form 943, Employer's Annual Federal Tax Return for Agricultural Employees, available to any employer below the small-employer threshold
C. Form 944, Employer's Annual Federal Tax Return, filed once per year by qualifying small employers instead of Form 941
D. Form 945, Annual Return of Withheld Federal Income Tax, covering all nonpayroll federal income tax withholding obligations

70. An employee who receives cash tips from customers earns $45 in tips during March at a single employer. Under the federal tip reporting rules, what is the employee generally required to do regarding these tips?

A. Report the tips to the employer in writing by the 10th of the following month using Form 4070 or a similar statement

B. Report the tips only on the employee's individual Form 1040 at year-end, with no obligation to notify the employer during the year
C. Report the tips to the employer only if the total for the entire year is reasonably expected to exceed $20,000 in tips
D. Report the tips to the IRS directly on Form 4137 within 30 days of receipt, bypassing any employer notification requirement

71. An employer maintains a written educational assistance program under Section 127 and pays $4,800 of an employee's graduate tuition during the year. How is this payment treated for federal employment tax purposes?

A. Fully includible in wages because Section 127 exclusions apply only to undergraduate coursework directly related to the employee's current job
B. Includible in wages above $250 because Section 127 caps the annual exclusion at a much lower amount than commonly assumed
C. Excludable only if the employee's graduate coursework is required by the employer to maintain the employee's present job or salary
D. Excludable from wages up to $5,250 annually because the payment falls within the Section 127 educational assistance program limit

72. An employer's written adoption assistance program reimburses an employee $10,000 of qualified adoption expenses during the year for the adoption of an eligible child. For federal employment tax purposes, how is this reimbursement treated?

A. Fully includible in wages for income tax, Social Security, and Medicare tax purposes because adoption benefits receive no special exclusion
B. Excludable from federal income tax wages up to the annual Section 137 limit, but still subject to Social Security and Medicare tax
C. Fully excludable from wages for all federal employment tax purposes, including income tax withholding, Social Security, and Medicare tax
D. Excludable only for Social Security and Medicare tax purposes, while remaining fully subject to federal income tax withholding on the full amount

73. A sole proprietor employs his spouse in the business, paying her reasonable wages for services performed. The spouse is not a partner or co-owner. How are these wages treated for FICA and FUTA purposes?

A. Exempt from both FICA and FUTA tax, identical to the treatment applied to wages paid to the proprietor's minor child
B. Subject to FICA tax withholding and matching, but exempt from FUTA tax under the services-for-spouse exclusion in Section 3306(c)(5)
C. Exempt from FICA tax withholding and matching, but fully subject to FUTA tax because no spousal exclusion exists for FUTA
D. Subject to both FICA and FUTA tax in full, with no exclusion available regardless of the family employment relationship involved

74. A corporation pays the full premium for group health insurance coverage on behalf of its employees under a plan that meets Section 106 requirements. How are these employer-paid premiums treated for federal employment tax purposes?

A. Included in wages for income tax withholding purposes only, while remaining excluded from Social Security and Medicare wage bases
B. Included in wages for Social Security and Medicare tax purposes only, while excluded from income tax withholding wages
C. Excluded from wages for income tax withholding, Social Security, and Medicare tax purposes because Section 106 covers accident and health plans
D. Included in wages for all federal employment tax purposes unless the employer also maintains a cafeteria plan under Section 125

75. An employer discovers that it under-reported Social Security wages on a previously filed Form 941 for an earlier quarter and wants to correct the error. Which form is used to correct the previously filed return, and what are the two available correction procedures?

A. Form 941-X, corrected using either the interest-free adjustment process for a timely-discovered error or a claim for refund
B. Form 940-X, corrected using either an amended annual filing or a request for abatement of the underlying employment tax

C. Form 843, corrected using either a formal protest letter or an informal conference request with the IRS Appeals Office

D. A superseding Form 941 filed before the original due date, which automatically replaces the earlier return without further explanation

76. An employer prepares paper Forms W-2 for its employees at year-end and must transmit copies to the Social Security Administration. Which form must accompany the paper Forms W-2 as the transmittal document?

A. Form 1096, Annual Summary and Transmittal of U.S. Information Returns, used for all paper wage and information return filings

B. Form 941, the same quarterly return used throughout the year to report withheld income tax and FICA tax amounts

C. Form 8809, Application for Extension of Time to File Information Returns, submitted alongside the employee wage statements

D. Form W-3, Transmittal of Wage and Tax Statements, summarizing the total wages and taxes reported on the accompanying Forms W-2

77. A business files several paper Forms 1099-NEC and Forms 1099-MISC with the IRS to report nonemployee compensation and other payments made during the year. Which form must be filed as the paper transmittal summarizing these information returns?

A. Form W-3, Transmittal of Wage and Tax Statements, which applies to any paper-filed federal information return submitted to the IRS

B. Form 8027, Employer's Annual Information Return of Tip Income, used to transmit any paper information returns filed by the business

C. Form 1096, Annual Summary and Transmittal of U.S. Information Returns, filed with each type of paper information return submitted

D. Form 945, Annual Return of Withheld Federal Income Tax, filed to summarize nonemployee compensation payments reported on paper returns

78. An employee dies in October, and the employer issues a final paycheck for wages earned before death to the employee's estate in December of that same year. How is this final wage payment treated for FICA and federal income tax withholding purposes?

A. Subject to both FICA tax and federal income tax withholding exactly as if the employee were still alive and receiving the wages

B. Subject to FICA tax withholding because paid in the year of death, but not subject to federal income tax withholding

C. Exempt from FICA tax withholding entirely, but fully subject to federal income tax withholding as ordinary wage income

D. Exempt from both FICA tax and federal income tax withholding because payment was made after the employee's date of death

79. A small employer with 20 employees does not offer a traditional group health plan but wants to reimburse employees tax-free for individual health insurance premiums and qualified medical expenses, subject to annual dollar caps. Which arrangement allows this employer to do so?

A. A Qualified Small Employer Health Reimbursement Arrangement (QSEHRA), available to eligible small employers that do not offer a group health plan

B. A cafeteria plan under Section 125, which permits any employer regardless of size to reimburse individual health insurance premiums tax-free

C. A dependent care assistance program under Section 129, extended to cover individual health insurance premiums for eligible small employers

D. A Section 105 self-insured medical reimbursement plan, available only to employers that also sponsor a traditional group health plan

80. A landowner rents farmland to a tenant farmer under a crop-share arrangement but does not materially participate in the production or management decisions of the farming operation. Where does the landowner report this rental income, and is it subject to self-employment tax?

A. On Schedule F as farm income, subject to self-employment tax because the income is generated by farming activity

B. On Schedule E as rental real estate income, subject to self-employment tax because crop-share rents are earned income

C. On Schedule C as trade or business income, subject to self-employment tax under the material participation exception

D. On Form 4835 as farm rental income, not subject to self-employment tax because the landowner does not materially participate

81. A trust distributes $6,000 of investment income to a 15-year-old beneficiary who has no earned income and is claimed as a dependent by her parents. Under the current kiddie tax rules, how is the portion of this unearned income exceeding the statutory threshold taxed?

A. At the beneficiary's own single filer tax rates, computed entirely independent of either parent's tax return

B. At the compressed trust and estate tax rates that would otherwise apply to an accumulating nongrantor trust

C. At a flat 37% rate regardless of the total amount of unearned income the child beneficiary received

D. At the parents' marginal tax rate, using Form 8615 to compute the child's tax on net unearned income

82. A taxpayer who is not a real estate professional owns rental real estate that generates $40,000 of net rental income for the year. The taxpayer's modified adjusted gross income exceeds the applicable threshold by $25,000. How is the 3.8% net investment income tax applied to this rental income?

A. It applies to the full $40,000 of net rental income regardless of the taxpayer's modified adjusted gross income

B. It does not apply because rental real estate income is categorically excluded from net investment income

C. It applies to the lesser of net investment income or the excess of MAGI over the threshold, here $25,000

D. It applies only if the taxpayer also owes the additional 0.9% Medicare tax on wages for the same year

83. A decedent's will leaves a life estate in rental property outright to the surviving spouse, with the remainder passing to the decedent's children upon the spouse's death. The executor makes no QTIP election, and the spouse holds no general power of appointment over the property. What is the estate tax result for this bequest?

A. No marital deduction is allowed because the interest is a nondeductible terminable interest passing to a third party

B. The full value of the property qualifies for the marital deduction because the spouse receives a life income interest

C. Half the value qualifies for the marital deduction under the terminable interest rule's automatic 50% exception

D. The bequest automatically converts to a qualified terminable interest property trust absent an executor election

84. A traditional IRA owner dies, naming her adult, non-disabled son as the sole designated beneficiary of the account. The son is not considered an eligible designated beneficiary. Under the SECURE Act, by when must the inherited IRA generally be fully distributed?

A. By December 31 of the fifth year following the year of the IRA owner's death, with no interim distributions required

B. By December 31 of the tenth year following the year of the IRA owner's death, per the SECURE Act's 10-year rule

C. Over the son's single life expectancy, recalculated annually using the Uniform Lifetime Table for distributions

D. Immediately in a single lump-sum distribution within 60 days of the IRA owner's date of death, no exceptions

85. A traditional IRA owner dies, naming his surviving spouse as the sole beneficiary of the account. As an eligible designated beneficiary, what option is available to the surviving spouse that is not available to a non-spouse designated beneficiary?

A. The spouse must withdraw the entire account balance within five years regardless of the owner's age at death

B. The spouse may roll the account into her own IRA and defer distributions until her own required beginning date

C. The spouse must begin taking distributions immediately based on the deceased owner's remaining life expectancy figure

D. The spouse loses eligible designated beneficiary status automatically if she remarries before the tenth year passes

86. In the final tax year of an estate, the estate's deductions exceed its gross income, resulting in unused excess deductions upon termination. Under Section 642(h), how are these excess deductions treated?

A. They are permanently lost and provide no further income tax benefit to the estate or its beneficiaries at all

B. They carry forward indefinitely at the entity level in case the estate is later reopened for administration

C. They pass through to the beneficiaries succeeding to the estate's property, deductible on the beneficiaries' returns

D. They convert automatically into a net operating loss carryforward usable only by the estate's executor personally

87. A grantor establishes an irrevocable trust under which trust property will revert back to the grantor if a named beneficiary dies before a specified date. Actuarially, the value of this reversionary interest exceeds 5% of the trust's value at the time of the transfer. What is the income tax consequence to the grantor?

A. The trust is respected as a fully separate, nongrantor taxable entity because the reversion has not yet occurred

B. The grantor recognizes no income from the trust unless and until the reversionary interest actually takes effect

C. The trust automatically qualifies for a charitable income tax deduction offsetting the value of the reversion amount

D. The grantor is treated as the owner of the trust under Section 673, and trust income is taxed to the grantor

88. A business owner transfers limited partnership interests in a family limited partnership to her children as gifts. Because the transferred interests carry no control over partnership decisions and cannot be readily sold to outside parties, the appraiser applies certain reductions in determining fair market value. What are these reductions called?

A. Minority interest and lack of marketability discounts, which reduce the value reported for gift tax purposes

B. Special use valuation adjustments under Section 2032A, which apply only to farmland and closely held businesses

C. Blockage discounts, which apply exclusively to large, publicly traded stock holdings sold on an open market

D. Built-in gains tax adjustments, which reduce a C corporation's asset value before an S election is made

89. An estate elects special use valuation under Section 2032A for qualified farmland, reducing the property's value for estate tax purposes. Six years later, the qualified heir sells the farmland to an unrelated party who converts it to non-farm commercial use. What is the general consequence of this early disposition?

A. An additional estate tax is imposed on the qualified heir to recapture the tax benefit from the special use election

B. No consequence arises because the ten-year recapture period had already fully expired by the time of the sale

C. The original estate tax return must be entirely reopened and recomputed using the property's fair market value

D. The qualified heir must amend and refile the decedent's final individual income tax return for the year of death

90. A decedent transferred real property to her children during life but continued to occupy the property rent-free and receive its rental income until her death. Under Section 2036, how is this property treated for estate tax purposes?

A. It is entirely excluded from the gross estate because legal title had already passed to the children before death

B. It is included at its value on the date of the original lifetime transfer rather than its value at death

C. It is excluded from the gross estate but subject instead to a separate generation-skipping transfer tax charge

D. It is included in the gross estate at its date-of-death value because the decedent retained enjoyment of the property

91. A decedent made a gift of stock to her son fourteen months before her death and paid gift tax directly on the transfer from her own funds. The decedent died within three years of making the gift. Apart from any life insurance policy rules, what does Section 2035 require regarding this transfer?

A. The stock's full date-of-death value must be included in the gross estate regardless of when the gift was made

B. The gift is disregarded entirely for estate tax purposes because gift tax was already paid at the time of transfer

C. The gift tax paid on the transfer is added back into the gross estate under the three-year gross-up rule

D. The transfer is recharacterized as a taxable distribution subject to the generation-skipping transfer tax instead

92. A married individual makes a $36,000 gift to her adult daughter during the year from her own separate funds. Her spouse did not make any gift to the daughter but consents to treat the gift as made one-half by each spouse. What does this gift-splitting election accomplish?

A. It shifts the entire gift tax liability to the nondonor spouse, relieving the donor spouse of any reporting duty

B. It treats each spouse as having made an $18,000 gift, allowing both spouses' annual exclusions to apply to it

C. It requires the nondonor spouse to file a separate gift tax return reporting the full $36,000 as his own gift

D. It automatically qualifies the gift for the unlimited marital deduction as though it passed between the spouses

93. A small business's qualified retirement plan has 65% of its total account balances concentrated in accounts of key employees, exceeding the statutory top-heavy threshold. What does top-heavy status generally require the employer to provide?

A. A minimum contribution or benefit accrual for non-key employees, along with accelerated vesting schedule requirements

B. Immediate termination of the plan and a mandatory distribution of all account balances to every participant involved

C. A complete freeze on further contributions for key employees until the plan falls back below the threshold

D. Automatic disqualification of the plan's tax-exempt status until an independent fiduciary audit is completed fully

94. A qualified retirement plan uses a vesting schedule under which a participant becomes 100% vested in employer contributions only after completing exactly three years of service, with no partial vesting before that point. What type of vesting schedule is this?

A. A graded vesting schedule, which vests a participant gradually over a period of up to six or seven years
B. A normal retirement age schedule, which vests a participant only upon reaching the plan's stated retirement age
C. A cliff vesting schedule, which vests a participant fully all at once after satisfying the required service period
D. An immediate vesting schedule, which vests a participant fully from the participant's very first day of employment

95. A tax-exempt organization's unrelated business taxable income computation generally excludes certain categories of passive income even when derived from an otherwise unrelated activity. Which of the following is generally excluded from unrelated business taxable income under the modifications?

A. Net income earned from operating an unrelated retail gift shop that is regularly carried on by paid staff
B. Advertising revenue earned in a periodical that is regularly sold to the general public for a subscription fee
C. Income from an unrelated trade or business conducted primarily by unpaid volunteers on a for-profit basis
D. Dividends, interest, and royalties, along with rents from real property that is not debt-financed by the organization

96. A taxpayer has accumulated suspended passive activity losses from a rental real estate activity over several years because income was insufficient to absorb them. The taxpayer then sells her entire interest in the activity to an unrelated party in a fully taxable transaction. What happens to the previously suspended losses?

A. They remain suspended indefinitely and can only offset future passive income from a replacement rental activity

B. They become fully deductible against nonpassive income in the year of the disposition under Section 469(g)
C. They are permanently disallowed because the activity itself, rather than the taxpayer, has been disposed of
D. They convert into a capital loss carryforward usable only against future capital gains for the following five years

97. A parent establishes a trust funded with the disabled beneficiary's own settlement proceeds from a personal injury lawsuit, structured to supplement rather than replace government benefits. Under a self-settled special needs trust, what must occur upon the beneficiary's death?

A. Remaining trust assets pass automatically and free of any claim to the beneficiary's chosen remainder beneficiaries
B. Remaining trust assets must first reimburse the state Medicaid program for benefits paid during the beneficiary's life
C. Remaining trust assets are distributed exclusively to a qualified charitable organization named in the trust instrument
D. Remaining trust assets revert automatically to the original personal injury defendant who funded the settlement

98. A complex trust's governing instrument directs the trustee to pay a portion of gross income each year to a qualified charitable organization. How does the trust's charitable contribution deduction under Section 642(c) generally differ from an individual's charitable deduction?

A. The trust deduction is not limited to a percentage of adjusted gross income, provided the amount is paid from gross income under the trust's governing instrument
B. The trust deduction is capped at a flat $5,000 per year, regardless of the trust's total gross income for that particular year
C. The trust deduction requires a qualified written appraisal for any noncash charitable contribution, regardless of the donated property's fair market value
D. The trust deduction is only allowed if the charitable payment is made within the first sixty-five days of the following tax year

99. A tax-exempt organization generates $1,500 of gross income from an unrelated trade or business during the year, along with related deductions directly connected to that activity. What role does the $1,000 specific deduction play in this computation?

A. It exempts the organization permanently from ever owing unrelated business income tax in any future tax year

B. It replaces the need to file Form 990-T entirely once the specific deduction reduces taxable income to zero

C. It applies only to organizations classified as private foundations rather than to public charities generally today

D. It is subtracted in computing unrelated business taxable income, and the organization must still file Form 990-T

100. A real estate investment trust wants to maintain its favorable tax status, under which it deducts dividends paid and generally avoids entity-level tax on distributed income. What percentage of its taxable income must the REIT distribute to shareholders each year to qualify?

A. At least 50% of its ordinary taxable income, excluding any net capital gain realized during the year entirely

B. At least 75% of its ordinary taxable income, plus all of its net capital gain realized during the year

C. At least 90% of its ordinary taxable income, computed before the dividends-paid deduction itself is taken

D. At least 100% of its ordinary taxable income, with no netting of capital losses against capital gains permitted

Answer Key and Explanations — Practice Exam 19, Part 2: Businesses

1. B — Under Reg. Section 1.752-2, the constructive liquidation assumes all partnership assets become worthless, every liability becomes due and payable, and the partnership disposes of all assets for no consideration. Whichever partner would then be obligated to satisfy the liability, considering payment obligations and contribution requirements, bears the economic risk of loss and receives the basis allocation.

2. A — Section 707(a)(2)(A) recharacterizes purported profit allocations as disguised payments for services, taxed as ordinary income, when the arrangement lacks significant entrepreneurial risk, such as fee waivers tied closely to a predetermined amount. Regulations examine factors including risk, allocation timing, and whether the arrangement resembles a fee more than a genuine share of partnership profit and loss.

3. D — In a tiered structure, the upper-tier partnership's outside basis in the lower-tier partnership is adjusted under the same Section 705 rules that apply to any partner. A cash distribution exceeding that basis reduces it to zero, and Upper recognizes gain under Section 731 on the excess, which then flows through to Upper's own partners.

4. C — Under Section 704(e)(2), when capital is not a material income-producing factor, the family partnership rules require that reasonable compensation for services actually performed by each family member be allocated first. Only the remaining income may then be divided according to capital ownership, preventing income shifting to family members who contribute little beyond a nominal gifted interest.

5. A — The economic effect equivalence test under Reg. Section 1.704-1(b)(2)(ii)(i) allows allocations to be respected without formal capital accounts if, as of the end of every year, a hypothetical liquidation would produce the same economic outcomes to partners that the primary capital-account-based test would produce, ensuring allocations still track real economic consequences rather than existing only on paper.

6. D — Section 731(c) generally treats marketable securities distributed by a partnership as money, not property, for gain-recognition purposes. A partner therefore recognizes gain to the extent the securities' fair market value, reduced by certain adjustments, exceeds the partner's outside basis immediately before the distribution, closing a potential avenue for avoiding gain through in-kind security distributions.

7. B — Under the BBA regime, a partnership may make a timely push-out election under Section 6226 instead of paying the imputed underpayment itself. The partnership furnishes adjustment statements to the reviewed-year partners, who then report their share of the adjustment and any associated interest on their own returns, rather than the entity bearing the liability directly.

8. C — Even with formal economic effect, an allocation must also be substantial. Shifting allocations, which change year-to-year tax results without meaningfully altering partners' economic shares, and transitory allocations, which are largely offset by later allocations, generally fail the substantiality requirement because their strong likelihood is that they merely reduce the partners' aggregate tax liability.

9. C — The nonfarm optional method lets a sole proprietor with low net profit report two-thirds of gross nonfarm income as net earnings from self-employment, subject to statutory dollar limits and eligibility conditions, similar to the farm optional method. This can preserve Social Security earnings credit in a low-profit year, though it also increases current self-employment tax owed.

10. D — Recent litigation, including the Soroban line of cases, has scrutinized the Section 1402(a)(13) limited partner exception by looking past a partner's formal state-law designation. Courts and the IRS increasingly examine the partner's functional role, including active management, decision-making authority, and services performed, to determine whether self-employment tax exposure should apply despite a limited partner label.

11. B — When a partnership revalues property upon a new partner's admission, reverse Section 704(c) principles apply to the resulting book-tax disparity, much as they do for originally contributed property. The pre-revaluation built-in gain or loss remains allocated to the existing partners, preventing the incoming partner from being taxed on appreciation that occurred before her admission.

12. A — Section 732(c) allocates a partner's limited outside basis first to unrealized receivables and inventory items, up to the partnership's inside basis in those items, before any remaining basis is allocated to other distributed property based on relative fair market values, with further adjustment if the total inside basis exceeds the partner's available outside basis.

13. A — Under Section 1402(b), the Social Security (OASDI) wage base applied to self-employment income is coordinated with wages already subject to FICA tax. Wages received from an employer reduce the remaining OASDI ceiling available for self-employment earnings, so only the portion of combined income up to the annual wage base bears the OASDI component of self-employment tax.

14. C — Beyond the Section 751 ordinary income component, look-through rules under the regulations require the remaining capital gain on a partnership interest sale to reflect the character of underlying assets. This can include 28% rate gain attributable to collectibles and unrecaptured Section 1250 gain from prior depreciation, so the capital gain is not taxed at a single flat rate.

15. D — The Tax Cuts and Jobs Act repealed the technical termination rule for tax years beginning after 2017. A sale or exchange of 50% or more of partnership capital and profits interests within twelve months no longer causes termination by itself; the partnership continues unless it actually ceases operating or drops to fewer than two partners under Section 708(b)(1).

16. B — Under Section 465(e), when a partner's at-risk amount is reduced below zero, generally due to distributions or losses exceeding her at-risk basis, she must recapture income equal to the excess amount, limited to prior losses previously allowed under the at-risk rules. This recaptured amount can then be treated as a suspended deduction in a future year.

17. D — A Section 754 election, once made, applies to all subsequent years unless properly revoked. Revocation is not automatic and generally requires the partnership to file a request with the IRS district director and obtain the Commissioner's consent, typically by demonstrating a substantial change in circumstances that justifies discontinuing the basis adjustment procedure going forward.

18. C — When business use of Section 179 property drops to 50% or below in a later year, the proprietor must recapture as ordinary income the excess of the Section 179 deduction claimed over the depreciation that would have been allowable using the regular MACRS method, reported on Form 4797, reducing the asset's basis accordingly going forward.

19. B — Section 351(g) carves preferred stock with debt-like features—mandatory redemption, put or call rights, or dividend rates tied to market interest—out of the definition of qualifying stock. This nonqualified preferred stock is treated as boot rather than stock, so the transferor recognizes gain to the extent of its fair market value, even though the balance of the exchange can still qualify.

20. A — Section 1059 targets corporate shareholders who receive extraordinary dividends shortly after acquiring stock and shelter much of the dividend with a dividends-received deduction. The nontaxed portion of the dividend reduces the shareholder's stock basis dollar for dollar, and once basis reaches zero, any further reduction is recognized immediately as gain on the stock.

21. D — A pro rata distribution followed soon afterward by a sale or exchange of the distributed stock is a strong device indicator under Section 355, since it suggests the spinoff functioned as a disguised means of converting corporate earnings into capital gain. Continued active business operation, a documented business purpose, and absence of post-distribution trading all point away from device treatment.

22. C — Section 291 is a corporate-only preference-item provision that increases recapture beyond what Section 1250 alone would require. It treats 20% of the amount that would have been ordinary income had the property instead been Section 1245 property as additional ordinary income, effectively narrowing the capital gain treatment corporations would otherwise receive on the disposition.

23. A — Section 267(f) extends the related-party matching principle to members of the same controlled group, deferring rather than permanently disallowing losses on intercompany sales of property. Corporation X's loss stays deferred while the property remains within the controlled group and is generally triggered into recognition once the property is sold, exchanged, or otherwise leaves the group in a taxable event.

24. B — Section 1361(c)(2)(A)(iii) lets stock passing to a trust by reason of a shareholder's death, including a testamentary trust that is neither a QSST nor an ESBT, count as an eligible S corporation shareholder for up to two years from the transfer date, with no special election needed. Afterward, the trust must qualify under another permitted category or the election terminates.

25. A — Section 6662 imposes a 20% accuracy-related penalty on underpayments attributable to a substantial understatement of income tax, among other triggers such as negligence. For corporations, a substantial understatement generally means the understatement exceeds the lesser of 10% of the tax required to be shown, or a specified dollar threshold, subject to reasonable cause and adequate disclosure defenses.

26. B — Section 280G denies the paying corporation a deduction for the portion of a parachute payment classified as excessive, and Section 4999 separately imposes a 20% nondeductible excise tax on the disqualified individual who receives it. Together these provisions discourage large change-in-control payments by penalizing both the corporate payer and the recipient rather than simply taxing the amount as ordinary compensation.

27. C — A Section 336(e) election lets qualifying sellers of stock treat a disposition as if the target sold all its underlying assets in one deemed transaction, giving the purchaser a stepped-up asset basis without an actual corporate purchaser or the eighty-percent purchasing-corporation rule that Section 338(h)(10) demands. The stock sale itself is then disregarded for tax purposes.

28. D — A reverse triangular merger under Section 368(a)(2)(E) requires that, after the merger, Target hold substantially all of its own historic assets plus those of the merger subsidiary, and that Acquiring obtain control of Target in exchange for voting stock of Acquiring. The merger subsidiary itself disappears into Target, so it cannot survive as a separate operating entity.

29. C — The separate return limitation year rules generally prevent a member's pre-affiliation losses from sheltering income generated by other group members, confining their use to the consolidated income the joining member itself contributes after joining. This prevents a loss corporation's history from being used to shelter unrelated income earned by profitable members already in the group.

30. B — For closely held C corporations that are not personal service corporations, Section 469's modification allows passive losses to offset net active business income, though not portfolio income such as interest and dividends. This narrower relief, unavailable to individuals or personal service corporations, recognizes that closely held corporations often blend active and passive activities under common management.

31. D — Section 1563(a)(1) defines a parent-subsidiary controlled group as one or more chains of corporations connected through at least 80% common ownership by vote or value, with a common parent at the top. Because the parent directly owns each subsidiary at the required threshold, the four corporations form a parent-subsidiary group even though the subsidiaries hold no stock in each other.

32. A — Section 302(b)(1) offers a facts-and-circumstances alternative to the mechanical safe harbors, asking whether the redemption results in a meaningful reduction of the shareholder's proportionate interest in voting power, earnings entitlement, and net assets. A minority shareholder who loses real voting and management influence can satisfy this test even when the numeric thresholds of (b)(2) or (b)(3) are not met.

33. B — Absent a closing-of-the-books election, the default rule allocates the corporation's annual items ratably between the short S year and short C year based on the number of days each period comprises. This pro rata method avoids the administrative burden of an actual interim closing but can mismatch income recognition with when items actually accrued during the year.

34. C — Under the consolidated return intercompany transaction regulations, gain or loss on a sale between group members is generally deferred at the time of the intercompany sale and recognized later, typically when a triggering event occurs, such as the property being resold outside the group or otherwise leaving the consolidated group in a recognition transaction.

35. D — Because a single-member LLC that has not elected corporate status is disregarded for federal income tax purposes, its ownership of S corporation stock is looked through directly to the individual owner. As long as that owner is otherwise an eligible individual shareholder, the disregarded LLC's presence in the ownership chain does not disqualify the S election.

36. A — Under Section 461(h)(2)(A), when a liability requires the taxpayer to provide services to another, economic performance occurs as the services are actually performed, not upon contract execution, financial statement accrual, or receipt of prepayment. This actual-performance standard ties deductibility to real economic activity rather than bookkeeping or contractual commitment alone.

37. C — Section 1091(a) exempts losses a securities dealer sustains on transactions made in the ordinary course of the dealer business, so wash sale disallowance does not reach ordinary trading inventory. Securities properly identified as held for investment under Section 1236 fall outside that exception, so a loss on repurchased identical investment securities is disallowed.

38. D — Under the cash equivalency doctrine, a cash-method taxpayer recognizes income from a note only when it functions as cash — freely transferable, readily marketable, and backed by an assured obligor. A non-negotiable, unmarketable, unsecured note lacks these features, so income recognition is deferred until payments are actually collected, unlike a marketable note received from a solvent, creditworthy payer.

39. B — IRS guidance generally treats soil and groundwater remediation costs as currently deductible business expenses when the work merely restores contaminated property to its original condition rather than improving, adapting, or extending its useful life beyond that baseline. Capitalization applies only when the work produces a genuine betterment to the property.

40. A — A Section 468B qualified settlement fund lets the defendant claim an economic performance deduction upon transferring funds into the court-supervised fund, satisfying the payment requirement even though individual claimants have not yet been paid. The fund itself remains a separate taxable entity subject to tax on income it earns, so the transfer does not eliminate the corporation's tax liability entirely.

41. B — Timber depletion uses cost depletion on a units basis: depletion basis divided by total estimated recoverable units gives a per-unit rate ($180,000 ÷ 90,000 board feet = $2), multiplied by units cut and sold (15,000 × $2 = $30,000). Percentage depletion is not permitted for timber; only cost depletion applies here.

42. A — Under the tax benefit rule of Section 111, a recovery of an amount previously deducted is included in current-year gross income to the extent the earlier deduction actually reduced the taxpayer's tax liability. Any portion of the deduction that produced no prior tax benefit is excluded from the recovery amount.

43. C — Section 483 imputes unstated interest on certain deferred payment sales that lack adequate stated interest and are not otherwise covered by the original issue discount rules. A portion of the stated sale price is recharacterized as interest, taxable as ordinary income to the seller and generally deductible interest expense to the buyer.

44. D — Section 451(d) permits a cash-method farmer to elect to defer crop insurance proceeds received for physical crop damage to the following tax year, but only by establishing that, under the farmer's normal business practice, income from the destroyed crop would have been reported in that later year absent the damage.

45. A — As amended by the Tax Cuts and Jobs Act, Section 174 no longer allows current deduction of research and experimental expenditures. Domestic costs must instead be capitalized and amortized ratably over five years, using a mid-year convention, regardless of whether the underlying research succeeds or produces a patentable result, unlike foreign research costs, which instead amortize over fifteen years.

46. B — Section 163(j) generally limits deductible business interest expense to the sum of business interest income, floor-plan financing interest, and 30% of adjusted taxable income. With $500,000 of adjusted taxable income and no other interest income or floor-plan interest, the deductible limit equals 30% times $500,000, or $150,000, and any disallowed excess interest generally carries forward indefinitely to future tax years.

47. C — Business meals with clients remain generally 50% deductible when the taxpayer or an employee is present and the meal is not lavish or extravagant. Entertainment expenses, including tickets to sporting or similar events, were made entirely nondeductible by the Tax Cuts and Jobs Act, even when directly connected to business discussions.

48. D — Under the completed contract method, a contractor defers reporting any gross income or allocable contract costs until the tax year the contract is completed and accepted by the customer. This differs from the percentage-of-completion method, which recognizes income and costs progressively as the contract is performed based on costs incurred.

49. B — For liabilities requiring the taxpayer to make a payment to another person, such as a rebate or refund, Section 461(h) generally treats economic performance as occurring only when the taxpayer actually makes the payment. Signing the agreement, accruing an estimate, or the customer merely becoming eligible does not satisfy economic performance.

50. A — Post-2017 net operating losses are generally limited to 80% of taxable income, computed without regard to the NOL deduction itself, for the year to which they are carried. Unlike pre-2018 NOLs, current-law NOLs also carry forward indefinitely rather than expiring after twenty years, though they generally cannot be carried back.

51. C — The Section 179 taxable income limitation aggregates net income and losses from all actively conducted trades or businesses, plus wages earned as an employee, treated as derived from a trade or business. Business A's $55,000 profit, Business B's $15,000 loss, and $40,000 of wages combine to $80,000, exceeding the $75,000 cost, so the full deduction is allowed.

52. D — The One Big Beautiful Bill Act permanently restored 100% first-year bonus depreciation under Section 168(k) for qualified property acquired and placed in service after January 19, 2025, replacing the phase-down schedule that would otherwise have reduced the rate to 40% for 2025. The 60% and 80% rates applied to 2024 and 2023 property, respectively.

53. C — Sport utility vehicles rated between 6,000 and 14,000 pounds are subject to a special, annually indexed Section 179 dollar cap, even though they exceed the luxury auto weight threshold. A heavy pickup truck with an open cargo bed and no rear passenger seating generally does not meet the SUV definition, so it escapes that specific capped limit.

54. A — To aggregate multiple trades or businesses for the QBI deduction, the same person or group must own 50% or more of each business, the aggregated businesses must share the same tax year, and none may be an SSTB, along with satisfying at least two of three additional factors showing shared products, services, facilities, or centralized business elements.

55. D — Property used predominantly outside the United States during the tax year is among the categories of property for which Section 168(g) mandates use of the Alternative Depreciation System, generally producing longer recovery periods and straight-line depreciation. Regular MACRS under the General Depreciation System is unavailable, and neither Section 179 nor an arbitrary useful life applies instead.

56. B — The low-income housing credit is generally claimed ratably over a 10-year credit period, but the property must satisfy low-income occupancy and rent restrictions throughout a longer 15-year compliance period. Failing to maintain compliance during that 15-year window can trigger recapture of a portion of credits already claimed, plus interest, unlike the rehabilitation credit's shorter timeline.

57. D — Under the traditional method, the research credit equals 20% of qualified research expenses exceeding a base amount derived from the corporation's historical fixed-base percentage applied to average gross receipts. The simpler ASC method instead applies a 14% rate to qualified research expenses exceeding 50% of the average of the preceding three years' expenses, easing the computation.

58. A — Unrecaptured Section 1250 gain, representing the portion of gain on depreciable real property attributable to straight-line depreciation, is taxed at a special maximum rate of 25% rather than ordinary income rates or the standard 15%/20% long-term capital gain rates, regardless of the taxpayer's overall ordinary income tax bracket for the year.

59. C — The general business credit is generally limited to net income tax reduced by the greater of the taxpayer's tentative minimum tax or 25% of net regular tax liability exceeding $25,000. This preserves a minimum tax floor, unlike claims that tentative minimum tax is irrelevant, eliminates the credit entirely, or doubles the amount allowed.

60. B — Beyond the base startup cost credit, Section 45E provides eligible employers an additional flat-dollar credit, generally up to $500 per year for three years, for adding an eligible automatic contribution arrangement to a new or existing plan. This flat credit is separate from doubling the base percentage, testing exemptions, or a refundable credit tied to balances.

61. B — A cost segregation study identifies components of a building, such as certain electrical or plumbing systems serving specific equipment, decorative finishes, and land improvements, that qualify as personal property or land improvements with shorter 5-, 7-, or 15-year MACRS lives rather than the building's 39-year life, accelerating depreciation and potentially qualifying components for bonus depreciation.

62. D — Within the SSTB phase-in range, the applicable percentage of QBI, W-2 wages, and UBIA taken into account equals 100% minus the taxpayer's percentage progression through the range. Here, $25,000 of the $50,000 range has elapsed, an even 50%, so only half of the SSTB's QBI, wages, and UBIA enter the computation before the wage limitation applies.

63. C — Under Section 179(d)(6), all component members of a controlled group are treated as a single taxpayer for purposes of the Section 179 dollar limitation and phase-out threshold. The group's single limitation must be apportioned among the members, either by their written consent or a statutory default allocation, rather than each member claiming a full separate limit.

64. A — Section 248 permits a corporation to immediately deduct up to $5,000 of organizational expenditures, reduced dollar-for-dollar once such costs exceed $50,000, with the remaining balance amortized ratably over 180 months beginning with the month business begins. This mirrors the Section 195 start-up cost mechanic but applies specifically to costs of forming the corporate entity.

65. B — Percentage depletion cannot exceed 65% of the taxpayer's taxable income from all sources, computed before the depletion deduction itself. Any amount disallowed under this ceiling is not lost; it carries forward and may be deducted in future years, subject to the same 65%-of-taxable-income limitation, unlike the property-specific basis limit governing cost depletion.

66. C — Section 530 of the Revenue Act of 1978 bars the IRS from retroactively reclassifying workers as employees for employment tax purposes when the business had a reasonable basis, such as industry practice, and consistently treated similar workers alike, including filing required information returns. No IRS determination letter is required for this relief to apply.

67. A — Form W-4 Step 2 offers multiple-job households three options: the IRS Tax Withholding Estimator, the Multiple Jobs Worksheet, or checking a box for two jobs with similar pay. These tools calculate additional withholding needed to avoid under-withholding when combined household income pushes the taxpayer into a higher bracket than either job reflects alone.

68. D — Section 132(e) excludes de minimis fringe benefits from wages when their value and frequency make accounting for them unreasonable or administratively impractical, such as occasional snacks, holiday gifts of nominal value, or minor personal use of office equipment. No dollar threshold or accountable plan requirement applies, though cash and cash equivalents never qualify.

69. C — Form 944 lets qualifying small employers, generally those with an annual employment tax liability of $1,000 or less, file and pay once a year instead of quarterly on Form 941, reducing filing burden. The IRS must first notify the employer of eligibility; an employer cannot switch to Form 944 on its own initiative.

70. A — Employees who receive $20 or more in tips during a calendar month from a single employer must report the tips to that employer in writing by the 10th day of the following month, typically using

Form 4070 or an equivalent statement, so the employer can withhold income tax and FICA tax on the reported tips.

71. D — Section 127 permits employers to exclude up to $5,250 per employee annually for tuition, fees, and related educational expenses paid under a written, nondiscriminatory educational assistance program, regardless of whether the coursework relates to the employee's current job. Amounts exceeding $5,250 generally become taxable wages unless another exclusion, such as working condition fringe, applies.

72. B — Section 137 excludes qualified adoption expenses reimbursed under an employer's written adoption assistance program from federal income tax wages, up to the annual inflation-adjusted dollar limit. Unlike income tax withholding, this exclusion does not extend to Social Security and Medicare tax, both of which still apply to the full reimbursed amount received.

73. B — Wages paid to a spouse employed in a sole proprietorship are subject to FICA tax withholding and matching like any other employee's wages. However, Section 3306(c)(5) exempts services performed by an individual in the employ of a spouse from FUTA tax entirely, a narrower exclusion than the combined FICA and FUTA exemption for a minor child.

74. C — Section 106 excludes employer contributions toward accident and health plans, including group health insurance premiums, from an employee's gross income and wages for income tax withholding, Social Security, and Medicare tax purposes. This broad exclusion applies whether the coverage is provided directly or through a Section 125 cafeteria plan arrangement.

75. A — Form 941-X corrects errors discovered on a previously filed Form 941. Employers generally use the interest-free adjustment process when the error is discovered and corrected before the due date of the return for the period of discovery, or otherwise file a claim for refund or abatement using the same form and applicable procedure.

76. D — Form W-3 transmits paper Forms W-2 to the Social Security Administration and summarizes total wages, tips, and taxes withheld across all accompanying W-2s for the employer. Form 1096 serves an equivalent transmittal function for other paper information returns like Forms 1099, but W-2s are always transmitted with Form W-3, not Form 1096.

77. C — Form 1096 is the paper transmittal summarizing Forms 1099, 1098, 5498, and W-2G filed with the IRS, and a separate Form 1096 accompanies each type of information return submitted. It is not required for electronically filed returns, and Forms W-2 instead use Form W-3 as their designated transmittal document rather than Form 1096.

78. B — Wages paid to a deceased employee's estate or beneficiary during the same calendar year as the employee's death remain subject to FICA tax withholding but are not subject to federal income tax withholding. If instead paid in a later calendar year, the payment becomes exempt from FICA tax as well and is reported on Form 1099-MISC.

79. A — A Qualified Small Employer Health Reimbursement Arrangement lets eligible small employers, generally those with fewer than 50 full-time employees, that do not offer a group health plan reimburse employees tax-free, within annual limits, for individual health insurance premiums and qualified medical expenses, provided employees maintain minimum essential coverage throughout the reimbursement period.

80. D — Farm rental income where the landlord does not materially participate in production or management decisions is reported on Form 4835, not Schedule F. Because there is no material participation, the income is not earnings from self-employment, so it escapes SE tax, unlike income from actively operating a farming business as owner-operator.

81. D — Under current kiddie tax rules (reinstated after the SECURE Act reversed the TCJA's trust-rate approach), a child's net unearned income above the statutory threshold is taxed at the parents' marginal rate, computed on Form 8615, rather than at compressed trust rates or a flat rate, preventing families from shifting investment income into a lower-bracket child's return.

82. C — Section 1411 imposes a 3.8% net investment income tax on the lesser of net investment income or the excess of modified adjusted gross income over the applicable threshold. Rental income from a non-professional is passive investment income, so only the $25,000 MAGI excess, not the full $40,000 of rental income, is subject to the tax.

83. A — The terminable interest rule generally denies the marital deduction for interests passing to the surviving spouse that will terminate and pass to a third party, unless a recognized exception like a QTIP election or a general power of appointment applies. With neither exception present here, no marital deduction is allowed for this life estate bequest.

84. B — Under the SECURE Act's 10-year rule, a non-eligible designated beneficiary inheriting a traditional IRA must fully distribute the account by December 31 of the tenth year following the owner's death. Annual withdrawals within that ten-year window remain flexible and are not mandated each year, but the entire remaining balance must be gone by the deadline.

85. B — A surviving spouse qualifies as an eligible designated beneficiary and may roll the inherited IRA into her own IRA, treating it as her own account and deferring required distributions until her own required beginning date. That rollover option is unavailable to non-spouse designated beneficiaries, who are generally bound by the SECURE Act's ten-year distribution rule instead.

86. C — Section 642(h) allows excess deductions remaining in an estate's or trust's final tax year, after gross income has already been exhausted by other deductions, to pass through to the beneficiaries succeeding to the estate's or trust's property. Those beneficiaries then deduct the amounts on their own individual income tax returns rather than losing the benefit entirely.

87. D — Section 673 treats a grantor as the owner of a trust for income tax purposes whenever the grantor retains a reversionary interest exceeding 5% of the trust's value at inception, measured actuarially at the time of transfer. Grantor trust status means the trust's income, deductions, and credits are taxed directly to the grantor rather than to the trust.

88. A — Because gifted limited partnership interests carry no control over management decisions and cannot easily be sold to outside buyers, appraisers apply minority interest and lack of marketability discounts, reducing the interests' reported fair market value for gift tax purposes. These discounts are a widely used family limited partnership technique in lifetime estate-planning transfers to younger generations.

89. A — Section 2032A(c) imposes an additional recapture estate tax directly on the qualified heir if the specially valued property ceases qualified use or is disposed of to someone outside the family within the ten-year recapture period following the decedent's death. Selling farmland to an unrelated party for commercial use within six years squarely triggers this recapture tax.

90. D — Section 2036 pulls transferred property back into the gross estate at its date-of-death value whenever the decedent transferred it during life but retained possession, enjoyment, or the right to income from the property for life. Retaining rent-free use and rental income here means the property remains includible despite the earlier lifetime transfer of legal title to the children.

91. C — Section 2035(b) requires any gift tax actually paid on gifts made within three years of the decedent's death to be added back, or grossed up, into the gross estate, regardless of the underlying gifted asset's separate value or appreciation. This gross-up rule prevents depleting the taxable estate through last-minute gift tax payments made shortly before death occurs.

92. B — Under Section 2513, married spouses may jointly elect to treat a gift made by one spouse as though made one-half by each spouse. This lets both spouses apply their individual annual exclusions, transforming the single $36,000 gift into two $18,000 gifts that fall entirely within the combined annual exclusion amount available to the couple for that year.

93. A — A top-heavy plan, meaning key employees hold more than 60% of total accrued account balances, must generally provide a minimum contribution or benefit accrual for non-key employees and often requires accelerated vesting schedules, ensuring rank-and-file employees still receive meaningful retirement benefits rather than the plan disproportionately favoring owners and other key employees of the business.

94. C — A cliff vesting schedule provides zero vesting until a participant completes the full required service period, three years in this example, at which point the participant becomes 100% vested all at once. This contrasts with graded vesting, which instead increases a participant's vested percentage incrementally over several years of continued creditable service with the employer.

95. D — Section 512(b) modifications exclude dividends, interest, royalties, and rents from real property from unrelated business taxable income, even when derived from an activity that would otherwise be unrelated, provided the property generating the income is not debt-financed. Regularly conducted business income like gift shop retail sales or sold periodical advertising remains fully taxable under the UBIT rules.

96. B — Section 469(g) allows previously suspended passive activity losses to become fully deductible against nonpassive income in the tax year the taxpayer disposes of her entire interest in the activity through a fully taxable transaction with an unrelated party, rather than the losses remaining suspended indefinitely or automatically converting into a limited capital loss carryforward for future years.

97. B — A self-settled, or first-party, special needs trust funded with the disabled beneficiary's own assets, such as litigation settlement proceeds, must include a Medicaid payback provision that reimburses the state for benefits paid during the beneficiary's lifetime before any remaining assets pass to other named remainder beneficiaries, distinguishing it from a third-party special needs trust funded by someone else.

98. A — Unlike an individual's charitable deduction, which is capped as a percentage of adjusted gross income, a trust's Section 642(c) charitable deduction carries no percentage-of-income ceiling, provided the contributed amount is paid from gross income pursuant to the express terms of the governing trust instrument, offering meaningfully more planning flexibility for trusts making charitable distributions each year.

99. D — The $1,000 specific deduction is subtracted much like an ordinary business deduction in computing an exempt organization's unrelated business taxable income, effectively functioning as a filing floor. Because the organization's gross unrelated business income here exceeds $1,000 before that deduction, the organization must still file Form 990-T even though the deduction reduces the taxable amount ultimately reported.

100. C — To maintain favorable REIT status and its corresponding dividends-paid deduction, a real estate investment trust must distribute at least 90% of its ordinary taxable income to shareholders annually, with that percentage computed before taking the dividends-paid deduction itself into account. Falling short of this distribution threshold jeopardizes the entity's pass-through tax treatment under Subchapter M of the Code.