PRACTICE EXAM 20: 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. Cascade Ventures, a newly formed general partnership, incurs $52,000 of qualifying organizational expenses in its first year, including legal fees for drafting the partnership agreement and state filing fees. Under Section 709(b), how must the partnership treat these costs on its first return?

A. The partnership may deduct the full $52,000 immediately in the year the expenses are paid, since organizational costs are always currently deductible in full for a new partnership entity.
B. The partnership must capitalize the entire $52,000 and may not deduct or amortize any portion until it liquidates, sells its assets, or otherwise completely terminates.
C. The $5,000 immediate deduction is reduced by $2,000 to $3,000 because expenses exceed $50,000, and the remaining $49,000 is amortized ratably over 180 months.
D. The partnership may deduct up to $10,000 immediately regardless of the total amount spent, with any remaining balance carried forward until the entity is sold.

2. Partner Devon holds a 25% interest in Ridgeline Partners. During the year, the partnership earns $40,000 of tax-exempt municipal bond interest, none of which is distributed. What is the effect of Devon's $10,000 share of this tax-exempt income on her outside basis in the partnership?

A. It has no effect on her outside basis because income that is excluded from gross income for regular tax purposes is also excluded from any basis adjustment calculation.

B. It increases her outside basis by $10,000, even though the income is never taxed, so that a later distribution of the same cash is not taxed twice.

C. It decreases her outside basis by $10,000 because tax-exempt income reduces the partnership's taxable earnings and therefore reduces each partner's economic investment proportionately.

D. It increases her outside basis by $10,000 only if the partnership makes a special election under Section 705 to treat tax-exempt income the same as taxable income.

3. In complete liquidation of her entire partnership interest, Partner Wren receives only a parcel of land (no cash and no other property). Immediately before the distribution, Wren's outside basis in her partnership interest is $90,000, and the partnership's inside basis in the land is $65,000. What is Wren's basis in the land after the distribution?

A. $65,000, because a distributee partner's basis in distributed property can never exceed the partnership's adjusted basis in that same property immediately before distribution.

B. $77,500, because the basis in liquidating property distributions is always split evenly between the partnership's inside basis and the partner's outside basis figures.

C. $90,000 minus the fair market value of the land, because any excess of outside basis over value is treated as a recognized capital loss.

D. $90,000, because in a liquidating distribution the partner's basis in the sole property received equals her entire outside basis immediately before the distribution.

4. A partnership agreement allocates all depreciation deductions to Partner Ito, but the agreement does not maintain capital accounts, does not require liquidation in accordance with capital account balances, and contains no deficit restoration obligation or qualified income offset. The allocation therefore has no economic effect whatsoever. How must the depreciation deduction instead be allocated for tax purposes?

A. According to the partners' interests in the partnership (PIP), determined by weighing factors such as capital contributions, historical profit and loss sharing, and the economic substance of the arrangement.

B. According to each partner's ownership percentage of partnership capital only, since capital percentage is the sole factor the Code permits once economic effect is absent.

C. According to the partnership agreement exactly as written, since partners retain unlimited freedom to allocate any specific item however they choose regardless of economic effect.

D. According to each partner's relative distributive share of gross income for the year, since gross income allocation is deemed a safe harbor substitute for lost deductions.

5. Sole proprietor Talia sells a delivery van used exclusively in her landscaping business, recognizing a $12,000 Section 1231 gain that is treated as long-term capital gain on her return. How does this gain affect her net earnings from self-employment for the year?

A. It is excluded from net earnings from self-employment entirely, because gain from the sale of business property is not derived from carrying on a trade or business.

B. It is included in full at ordinary rates for self-employment tax purposes, since the van was a depreciable asset used continuously in her trade or business.

C. It is included at 92.35% of the gain, the same reduction percentage applied to all other ordinary self-employment earnings reported on her Schedule SE.

D. It is included only to the extent the gain exceeds prior depreciation deductions claimed on the van, with the ordinary recapture portion subject to self-employment tax.

6. Under the centralized partnership audit regime enacted by the Bipartisan Budget Act (BBA), who has the sole authority to act on behalf of a partnership and bind all of its partners during an IRS examination, unlike the prior TEFRA tax matters partner regime?

A. Every general partner acting jointly, since the BBA regime requires unanimous written consent from all general partners before the IRS may finalize any proposed adjustment.

B. The partner with the largest capital account balance at the start of the reviewed year, determined automatically by the partnership's most recently filed balance sheet.

C. Each individual partner separately, since the BBA regime preserved and expanded the TEFRA-era right of every partner to participate directly in the examination proceedings.

D. The partnership representative, a person or entity designated by the partnership who has sole authority to bind the partnership and all its partners in the proceeding.

7. All three partners of Delta Supply Partners sell their entire interests in a single transaction to one unrelated corporate buyer, leaving the buyer as the sole owner of what was the partnership's business. What is the tax result for Delta Supply Partners?

A. Nothing changes for tax purposes, because a partnership's existence is defined solely by its state law filing status, which continues unaffected by any change in ownership.

B. The partnership automatically converts into an S corporation by operation of law whenever all interests are acquired simultaneously by a single corporate purchaser in one deal.

C. The partnership terminates under Section 708(b)(1), because it no longer has at least two partners to carry on its business, financial operations, or venture as a partnership.

D. The partnership continues to exist for tax purposes for a mandatory five-year transition period before termination is recognized, regardless of the change in ownership structure.

8. A parent gifts a limited partnership interest in a family manufacturing business to her 10-year-old child, but the parent retains sole authority to control the interest, unilaterally redirect its income, and revoke the gift at any time without the child's or a guardian's consent. How will the IRS most likely treat the child for family partnership purposes?

A. As a fully recognized partner immediately upon the gift, because Section 704(e) treats any completed transfer of a capital interest to a family member as automatically valid.

B. As not a bona fide partner, because the parent's retained control and revocation power show the child never received genuine dominion over the gifted interest.

C. As a bona fide partner only after the child turns eighteen, since Section 704(e) sets a fixed statutory age threshold below which no minor can ever hold an interest.

D. As a bona fide partner, but only for income tax purposes and never for purposes of determining the child's share of partnership liabilities or losses.

9. Partner Owens contributes $30,000 cash to a partnership activity. To protect her investment, she also purchases a nonrecourse guarantee from an unrelated insurance company that reimburses her for any loss on the investment up to $20,000. How does this loss-protection arrangement affect Owens's amount at risk under Section 465?

A. It has no effect on her at-risk amount, because at-risk amount is a purely rigid computation based only on cash and property contributed.

B. It increases her at-risk amount by $20,000, because insurance proceeds are treated identically to a cash capital contribution under Section 465.

C. It reduces her at-risk amount by the $20,000 protected against loss, because Section 465(b)(4) excludes amounts a taxpayer is protected against losing.

D. It converts her entire $30,000 cash contribution into qualified nonrecourse financing, which the regulations treat identically to a personal guarantee arrangement.

10. A partnership pays Partner Osei a $20,000 guaranteed payment for extraordinary services she performs in connection with acquiring a new office building the partnership will use in its business for many years. May the partnership currently deduct this guaranteed payment in the year paid?

A. Yes, guaranteed payments are always immediately deductible business expenses in the year paid, regardless of what activity or asset the underlying services relate to.
B. No, guaranteed payments are never deductible by the partnership under any circumstances, since they are instead treated solely as a nondeductible distribution of partnership profits.
C. Yes, but only half of the payment is deductible currently, with the remaining half automatically treated as a nondeductible reduction to the partnership's accumulated earnings.
D. No, because the payment relates to acquiring a long-lived business asset, general tax accounting principles require it to be capitalized rather than currently deducted like an ordinary expense.

11. During the year, Sable Partners pays a $15,000 penalty to a state agency for violating an environmental regulation. The penalty is nondeductible under Section 162(f) and does not create a capital asset. How does Partner Reyes's $3,000 share of this penalty affect her outside basis in the partnership?

A. It has no effect on her outside basis, because expenditures that are nondeductible on the partnership's return are automatically disregarded for all basis adjustment purposes.
B. It decreases her outside basis by $3,000, because Section 705(a)(2)(B) reduces basis for a partner's share of nondeductible, noncapitalizable partnership expenditures such as fines.
C. It increases her outside basis by $3,000, because payments the partnership can never deduct are treated as additional capital contributions made on the partner's behalf.
D. It decreases her outside basis only if the partnership also reduces its book capital accounts by the identical amount in the same taxable year.

12. Sole proprietor Marcus computes $28,260 of net earnings from self-employment for the year (after applying the 92.35% factor) and deducts one-half of his resulting self-employment tax as an above-the-line adjustment to income on Form 1040. Does this above-the-line deduction reduce his net earnings from self-employment used to calculate the self-employment tax itself?

A. No, the deduction for one-half of self-employment tax reduces adjusted gross income only; it has no effect on the net earnings figure used to compute the SE tax itself.

B. Yes, the deduction reduces net earnings from self-employment dollar-for-dollar before the 92.35% factor is applied, lowering the ultimate self-employment tax owed for the year.

C. Yes, but only the Social Security portion of the deduction reduces net earnings, while the Medicare portion has no effect on the self-employment tax computation.

D. No, because sole proprietors are not permitted to deduct any portion of self-employment tax; only partners in a partnership qualify for the above-the-line deduction.

13. Partner Yun contributes land she held as an investment for six years to a new partnership solely in exchange for a partnership interest, qualifying for nonrecognition under Section 721. What is Yun's holding period for the partnership interest she receives?

A. It tacks the six-year holding period of the contributed land, so Yun's partnership interest is treated as held for six years from the date of contribution.

B. It begins fresh on the date of contribution, because a partnership interest is always treated as a new capital asset regardless of the property exchanged for it.

C. It is suspended entirely until Yun's partnership interest is eventually sold, at which point the holding period is calculated retroactively using an averaging formula.

D. It tacks only half of the land's holding period, since Section 721 requires holding periods to be reduced by fifty percent whenever contributed property is appreciated.

14. Harborview Partners ceases its active retail business operations on March 1 but continues to collect outstanding receivables, pay off remaining creditors, and distribute its remaining cash to the partners through June 30, when the last distribution occurs. For federal tax purposes, when does the partnership actually terminate?

A. On March 1, the moment active business operations cease, because the partnership can no longer generate new income after that date under any circumstances.

B. On January 1 of the following year, because partnership terminations are only ever recognized as of the first day of the next full tax year.

C. On June 30, because the partnership is treated as continuing during the winding-up period while it collects receivables, pays creditors, and distributes remaining assets.

D. On the date the partnership agreement was originally signed, because that date controls the legal termination date regardless of when operations actually cease.

15. Partnership Ashgrove distributes inventory items to Partner Ferro in a nonliquidating distribution. Two years later, Ferro sells that inventory at a gain. How is the character of Ferro's gain on the later sale determined under Section 735?

A. The gain is automatically long-term capital gain because more than one year has passed between the distribution and the later sale of the inventory.
B. The gain is entirely tax-free to Ferro, because property already taxed once at the partnership level cannot be taxed again upon a later individual sale.
C. The character is elected by Ferro on her individual return, choosing freely between ordinary income and capital gain treatment regardless of what the property was.
D. The gain remains ordinary income if Ferro sells the property within five years of the distribution, because inventory retains its ordinary-income character during that period.

16. Adult daughter Nia purchases a 20% capital interest in her mother's family farming partnership for full and adequate consideration, paying with funds from her own separate savings account rather than money gifted or loaned by her mother. Capital is a material income-producing factor in the business. How does this affect the family partnership analysis under Section 704(e)?

A. It does not matter, because Section 704(e) applies identically to purchased and gifted interests, requiring the same reasonable compensation analysis regardless of how the interest was acquired.
B. Nia is recognized as the genuine owner of the purchased interest without the added scrutiny gift transactions receive, since a bona fide purchase for full value establishes real ownership.
C. The purchase is disregarded entirely, and Nia is treated as if she received the interest by gift from her mother, because family transactions are always presumed to be gifts.
D. Nia cannot be recognized as a partner at all until five years after the purchase date, since Section 704(e) imposes a mandatory waiting period on family transactions.

17. An individual actively conducts two related trades — a retail nursery and a landscaping service — through a single partnership, and wants to combine gains and losses from both operations into one activity for purposes of computing her amount at risk under Section 465. Under what circumstance is this aggregation generally permitted?

A. Aggregation is never permitted under Section 465, regardless of how closely related the two trades or businesses are, since each activity is always measured entirely separately.

B. Aggregation is automatically required for all partnership activities, since Section 465 mandates that every trade or business conducted by a single partnership be treated as one activity.

C. Aggregation is generally permitted when the taxpayer actively participates in the management of both trades or businesses, satisfying the active-participation standard for combining activities.

D. Aggregation is permitted only if both trades or businesses are separately incorporated as subsidiaries and file consolidated returns before combining their amount at risk calculations.

18. Following a BBA partnership-level audit, the IRS proposes an imputed underpayment computed at the highest individual tax rate for the reviewed year. The partnership believes this overstates the correct liability because several reviewed-year partners are tax-exempt entities that owe no tax on their share of the adjustment. What procedure allows the partnership to reduce the imputed underpayment?

A. The partnership must simply accept the imputed underpayment as calculated, since the highest individual rate is a fixed, non-negotiable figure that Section 6225 never allows to be adjusted.

B. The partnership must dissolve and reorganize as a new entity, which automatically resets the imputed underpayment calculation to reflect the partners' actual current tax rates.

C. Each reviewed-year partner must file a separate Tax Court petition individually challenging her own share of the imputed underpayment before any rate reduction is possible.

D. The partnership may request modification under Section 6225(c), which can lower the underpayment to reflect factors such as tax-exempt partners or partners filing amended returns.

19. Wanda owns 100% of the stock of both Bishop Corp and Falcon Corp, which are not members of a parent-subsidiary group. Wanda sells all of her Bishop Corp stock to Falcon Corp for $300,000 cash, and Bishop Corp has substantial earnings and profits. How is this transaction treated for federal tax purposes?

A. As a tax-free Section 351 transfer of property to a corporation Wanda controls

B. As a Section 304 redemption, taxed as a dividend to the extent of combined earnings and profits

C. As an installment sale of stock, with gain reported ratably as Falcon Corp makes payments

D. As a nontaxable exchange, because Wanda's total economic ownership of both corporations stays the same

20. Insolvent Corp is undergoing a Title 11 bankruptcy proceeding. Under a court-approved plan, substantially all of Insolvent Corp's assets are transferred to Reorg Corp solely in exchange for Reorg Corp stock, which is then distributed to Insolvent Corp's creditors and shareholders under the plan. What type of tax-free reorganization does this describe?

A. A Type G reorganization, the transfer of assets in a court-approved bankruptcy proceeding
B. A Type A reorganization, a simple statutory merger completed under state corporate law
C. A Type E reorganization, a recapitalization of the debtor corporation's outstanding securities
D. A Type F reorganization, a mere change of the debtor's identity or place of organization

21. A closely held C corporation earns most of its income from royalties and dividends rather than active business operations, and more than 50% of its stock is owned by five or fewer individuals. The corporation retains this passive income without distributing it to shareholders. Which additional corporate-level tax could apply?

A. The corporate alternative minimum tax computed on adjusted current earnings each year
B. The personal holding company tax on undistributed personal holding company income
C. The branch profits tax imposed on certain foreign corporations doing domestic business
D. The excess net passive income tax imposed only on certain former C corporations

22. Marcus is a member of a multi-member LLC taxed as a partnership. He holds a minority membership interest, performs no services for the LLC, and does not participate in management; his role is purely as a passive capital investor. For self-employment tax purposes, how is Marcus's distributive share of ordinary income generally treated?

A. Excluded from self-employment earnings under the limited partner exception, because his role is truly passive
B. Fully subject to self-employment tax, because all LLC members are automatically treated as general partners
C. Subject to self-employment tax only on the portion attributable to guaranteed payments he receives
D. Excluded entirely from federal tax because LLC membership interests are treated like corporate stock

23. Titan Corp, a C corporation, sells marketable securities held for investment and recognizes a long-term capital gain of $80,000 during the current tax year. Titan Corp has no capital losses to offset this gain. How is this capital gain taxed at the corporate level?

A. Exempt from tax entirely, because corporations do not recognize gain on investment securities

B. Taxed at a reduced 0% or 15% preferential rate, identical to individual long-term capital gain rates

C. Taxed at a flat 20% rate reserved exclusively for corporate net capital gains

D. Taxed at the same flat corporate rate that applies to the corporation's ordinary income

24. Regal Corp, a C corporation, sells depreciable nonresidential real property it has held for several years and recognizes a $60,000 gain that would be entirely Section 1231 gain if the taxpayer were an individual. No portion would be ordinary income recapture under Section 1250 for an individual seller. How does Regal Corp's corporate status affect the character of this gain?

A. It has no effect; Regal Corp reports the same character an individual seller would report

B. Regal Corp automatically recaptures the entire gain as ordinary income under Section 1245 instead

C. Section 291 requires Regal Corp to recharacterize 20% of the excess as additional ordinary income

D. Section 291 exempts Regal Corp from any recapture that would otherwise apply to an individual

25. Parent Inc. owns 85% of the vote and value of Subsidiary Corp's only class of outstanding stock, and the two corporations are not part of a consolidated group filing a single return. Subsidiary Corp pays Parent Inc. a $40,000 dividend out of current earnings and profits. What dividends-received deduction percentage applies to Parent Inc.?

A. 50%, the deduction percentage that applies to ownership below the 20% threshold

B. 100%, because Parent Inc. owns at least 80% of Subsidiary Corp's vote and value

C. 65%, the deduction percentage that applies to ownership of 20% but under 80%

D. 0%, because dividends between affiliated but non-consolidated corporations receive no deduction at all

26. Over several years, Priya, the sole shareholder of an S corporation, repeatedly advances funds to the corporation on open account without a written note, and the running balance exceeds $25,000 by year-end. For purposes of Priya's debt basis in the S corporation, how must this open account debt generally be treated?

A. It is disregarded entirely and can never generate debt basis regardless of the amount owed
B. It automatically converts the corporation's status, terminating the S election as of that year
C. It is treated as a separate, bona fide indebtedness once the balance exceeds $25,000
D. It is reclassified as a second class of stock, jeopardizing the S corporation's eligibility

27. Crest Corp completely liquidates and distributes a parcel of land with a fair market value of $50,000 and an adjusted basis of $90,000 to a shareholder who owns 60% of Crest Corp's stock. The distribution is not pro rata among all shareholders. How does Crest Corp treat the $40,000 built-in loss?

A. Crest Corp recognizes the full $40,000 loss without any limitation on liquidating distributions
B. Crest Corp defers the loss until the distributee shareholder later disposes of the land
C. Crest Corp converts the loss into a capital contribution adjustment on its own books
D. Section 336(d) disallows the loss because the distribution is non-pro rata to a related person

28. Members of a multi-member LLC taxed as a partnership vote to convert the LLC into a corporation by having the LLC contribute all of its assets and liabilities to a newly formed corporation in exchange for stock, which the LLC then distributes to its members in liquidation. Absent a contrary election, how is this conversion classified?

A. The default 'assets-over' method under Rev. Rul. 84-111, generally a tax-free Section 351 exchange
B. An automatic taxable liquidation of the LLC followed by a wholly separate corporate formation
C. A disregarded transaction with no federal tax consequences to the LLC or its members
D. A mandatory 'interests-over' conversion, the only method the IRS permits for LLCs

29. An S corporation has two trusts as shareholders. Trust One is a Qualified Subchapter S Trust (QSST) with a single income beneficiary who receives all trust income currently. Trust Two is an Electing Small Business Trust (ESBT) with several discretionary beneficiaries. How does the taxation of the S corporation's income differ between these two trusts?

A. Both trusts are taxed identically, since ESBT and QSST elections produce identical results
B. Neither trust type may legally hold S corporation stock under current Subchapter S rules
C. The QSST beneficiary reports the income; the ESBT is taxed at the top trust rate
D. The ESBT beneficiary reports the income directly; the QSST is taxed at the top trust rate

30. An S corporation has never been a C corporation and therefore has no accumulated earnings and profits. It distributes $30,000 cash to its sole shareholder, whose adjusted stock basis is $22,000 immediately before the distribution. How is the $8,000 excess over basis generally treated?

A. As ordinary dividend income, since all corporate distributions are presumed to be dividends
B. As capital gain, since the excess is treated as gain from a sale of the stock
C. As a tax-free return of capital, since the corporation lacks earnings and profits
D. As a nondeductible loss reported by the shareholder in the year of the distribution

31. Ridge Corp and Summit Corp are members of the same controlled group under Section 1563 and are not eligible for the personal service corporation rate limitation on the accumulated earnings credit. For purposes of computing each corporation's accumulated earnings tax exposure, how must the $250,000 minimum accumulated earnings credit be handled?

A. Each member independently claims the full $250,000 credit without regard to the other member
B. Only the member with the larger accumulated earnings and profits balance may claim any credit
C. The credit is eliminated entirely once two or more corporations form a controlled group
D. The $250,000 credit must be apportioned among the controlled group's component members by agreement or equally

32. An S corporation has outstanding written unsecured promissory notes issued to its sole shareholder, bearing a fixed interest rate and unconditional payment obligation not tied to corporate profits, convertible into nothing else. Which rule allows this debt instrument to avoid being treated as a disqualifying second class of stock?

A. The straight debt safe harbor, which excludes qualifying unconditional, non-convertible debt from stock classification
B. The de minimis exception, which disregards any debt instrument issued for less than $50,000

C. The related-party exception, which excludes any debt owed to a majority shareholder automatically
D. The passive investment income exception, which applies only to former C corporation earnings

33. Ken transfers property with an adjusted basis of $40,000, subject to a $65,000 mortgage the corporation assumes, to Cardinal Corp solely in exchange for Cardinal Corp stock, in an exchange that otherwise satisfies Section 351's control requirement. The mortgage was not incurred for a tax-avoidance purpose. What is the tax result to Ken?

A. No gain is recognized, because liabilities assumed in a Section 351 exchange are always disregarded
B. Ken recognizes gain of $25,000, the excess of liabilities assumed over his adjusted basis in the property
C. The exchange is fully taxable, and Ken recognizes gain equal to the entire $65,000 liability assumed
D. No gain is recognized, but any liabilities exceeding basis instead reduce Ken's stock basis below zero

34. A domestic LLC with two members files Form 8832 to elect corporate tax treatment effective January 1 of Year 1. In June of Year 2, the members want to file a new Form 8832 to change the LLC's classification back to partnership treatment. Under the entity classification regulations, what generally limits this second election?

A. Nothing limits it; entities may change their classification election as often as they choose each year
B. A second election is barred permanently once any prior election has been made under check-the-box
C. The 60-month rule generally prevents changing the election again within 60 months of the prior election's effective date
D. State law, not federal tax regulations, exclusively governs how often an LLC may change its classification

35. Six individuals form a new corporation, transferring a diversified mix of unrelated marketable securities in exchange for stock proportionate to each contribution, with no single individual acquiring control. The transferors together own 100% of the new corporation immediately afterward. Why might this transfer fail to qualify for Section 351 nonrecognition treatment?

A. Because six transferors exceeds the maximum number of shareholders permitted under Section 351

B. Because marketable securities can never be transferred tax-free to a corporation under any circumstance

C. Because proportionate stock issuances among unrelated transferors automatically disqualify a Section 351 exchange

D. Because the transferee is an investment company, and diversifying pooled securities triggers gain recognition

36. A cash-method sole proprietor's client mails a $9,000 payment check that arrives in the proprietor's mailbox on December 30, 2025. The proprietor is traveling and does not retrieve the mail or deposit the check until January 5, 2026. In which year must the $9,000 be included in gross income?

A. 2025, because the funds were made available to the proprietor without substantial restriction

B. 2026, because the proprietor did not actually possess or deposit the check until January

C. 2025, but only if the client specifically intended payment to be received that year

D. 2026, because income is reported only when funds physically clear the taxpayer's bank

37. Partner Ray owns a 55% interest in RayCo Partnership and reports on a calendar tax year. The two remaining partners each own 22.5% and use a June 30 fiscal year. Absent a business purpose exception or Section 444 election, what tax year must RayCo Partnership adopt?

A. A June 30 fiscal year, matching the minority partners' tax year

B. Any fiscal year the partnership selects with IRS advance consent

C. A calendar year, matching the majority interest partner's tax year

D. A 52-53 week year ending nearest to June 30 annually

38. On audit, the IRS determines that a business has been using an impermissible method of accounting and requires the business to change to a proper method for the year under examination. The resulting Section 481(a) adjustment increases taxable income by $80,000. Over how many years must the business generally recognize this adjustment?

A. Over four tax years beginning with the year of change

B. Entirely within the single year of change under examination

C. Over the number of years the improper method was used

D. Over four years beginning with the year after the change

39. Accrual-method Bexley Corp accrues a $15,000 deductible expense payable to its majority shareholder, a cash-method individual, in December 2025, but does not actually pay the amount until March 2026. Under the related-party matching rule of IRC Section 267(a)(2), when may Bexley Corp deduct the $15,000?

A. In 2025, the year the liability was properly accrued
B. In 2025, if paid within two and a half months
C. In whichever year produces the greater overall tax benefit
D. In 2026, the year the shareholder actually receives payment

40. Dalton is a real estate dealer who regularly subdivides and sells residential lots to customers in the ordinary course of his business. Dalton sells a lot this year and will receive payments over the next three years. May Dalton report the gain from this sale using the installment method?

A. No, dealer dispositions of property are excluded from the installment method
B. Yes, but only if the buyer is not a related party
C. Yes, because all real property sales qualify automatically for deferral
D. No, because the lot was held for personal, not business use

41. Marlowe sells business equipment in an installment sale for $200,000, receiving $40,000 at closing and the balance in equal payments over four years. Marlowe's gain includes $60,000 of Section 1245 depreciation recapture. When must Marlowe report the $60,000 of recapture income?

A. Ratably over the four-year period as payments are received
B. In full in the year of sale, regardless of cash received
C. Only in the year the final installment payment is collected
D. Never, since recapture does not apply to installment sales

42. A C corporation, not a tax shelter, has average annual gross receipts for the three preceding tax years of $22 million, below the inflation-adjusted small business gross receipts threshold under Section 448(c). May this C corporation use the cash method of accounting?

A. No, C corporations are categorically barred from the cash method regardless of gross receipts, unlike partnerships and S corporations.
B. Yes, but only if the corporation also elects out of maintaining any inventory for financial statement purposes entirely.
C. Yes, because the corporation's average gross receipts fall below the Section 448(c) threshold, qualifying it for the cash method exception.
D. No, because the cash method exception under Section 448(c) applies only to sole proprietorships and partnerships, never corporations.

43. An accrual-method business receives a $24,000 advance payment in November 2025 for a two-year service contract, with the services to be performed evenly through 2027. For financial statement purposes, the business recognizes $2,000 of the payment as revenue in 2025. Under the deferral method for advance payments, how much of the $24,000 must be included in gross income no later than 2026?

A. The full $24,000 must be included in gross income in 2025
B. Nothing, because services are performed on a straight-line basis
C. Only the amount actually spent providing services during 2026
D. The entire remaining $22,000 balance must be included by 2026

44. A medical practice organized as a personal service corporation performs services on credit and, based on its historical collection experience, does not expect to collect a portion of its accrued accounts receivable. The practice does not charge interest or penalties for late payment. Which accounting method feature allows the practice to exclude the uncollectible portion of accrued service income from gross income without waiting for a bad debt to become worthless?

A. The non-accrual experience method under Section 448(d)(5)
B. The specific charge-off method for deducting bad debts
C. The reserve method for estimating bad debt expense
D. An election out of the accrual method entirely

45. A bookkeeper discovers that a business's 2024 tax return mistakenly omitted $5,000 of properly accrued interest expense due to a simple posting error, while every other item was reported under the business's established accrual method. Correcting this single item on an amended return is best characterized as which of the following?

A. A correction of an error, not a change in accounting method
B. A change in accounting method requiring Form 3115 approval
C. A permissible automatic change under the applicable revenue procedure
D. An impermissible retroactive change barred without IRS consent

46. A retail business with average annual gross receipts for the three preceding tax years well under the inflation-adjusted small business exception threshold purchases inventory for resale. Must this business capitalize indirect costs to inventory under the UNICAP rules of Section 263A?

A. Yes, UNICAP applies to every business that resells inventory, regardless of the business's average annual gross receipts.
B. Yes, but only the direct labor costs must be capitalized; indirect costs are always immediately deductible for resellers.
C. No, because the business qualifies for the small business taxpayer exception, exempting it from the UNICAP capitalization requirement.
D. No, because UNICAP applies exclusively to manufacturers and producers, never to businesses that merely resell purchased inventory.

47. A business wants to change from an impermissible method of accounting to a permissible one that is listed on the IRS's approved list of automatic accounting method changes. Which of the following correctly describes how the business obtains IRS consent for this change?

A. It must request advance written consent from the National Office
B. It must pay a user fee and await a formal ruling
C. It cannot change methods without a private letter ruling
D. It files Form 3115 with its timely return, no fee required

48. A retail business wants its tax year to always end on the same day of the week each year (for example, the last Saturday in January) rather than on a fixed calendar date, to align with its weekly inventory cycle. Which type of tax year election allows this?

A. A calendar year election with a same-day extension
B. A 52-53-week tax year election under Section 441(f)
C. A short tax year election for a new business
D. A fiscal year election tied to inventory valuation dates

49. Priya sells investment land in an installment sale and holds a note receivable with a face amount of $100,000 and remaining basis of $40,000. Before collecting any further payments, Priya gives the note to her daughter as a gift. What is the tax consequence to Priya of this gift?

A. No gain is recognized because gifts are not taxable events
B. Gain is deferred until the daughter collects the note
C. Priya must recognize $60,000 of gain immediately upon the gift
D. Priya recognizes gain only to the extent of gift tax paid

50. A cash-method farmer plants a crop of wheat in the fall of 2025 that will not be harvested and sold until 2026, more than one year after planting. Under the crop method of accounting, when may the farmer deduct the costs of raising this crop, such as seed, fertilizer, and cultivation expenses?

A. In 2025, as each cost is actually paid during planting
B. Ratably over 2025 and 2026 based on months elapsed
C. In 2026, but only up to the crop's sale price
D. In 2026, the year the crop income is realized from sale

51. During 2025, Meridian Fabricators placed five items of 7-year MACRS equipment in service: $80,000 in March, $60,000 in June, and $210,000 in December (total $350,000 for the year). Which depreciation convention must the company use for all of its 2025 MACRS property?

A. Mid-quarter convention, because more than 40% of the year's depreciable basis was placed in service in the fourth quarter
B. Half-year convention, because MACRS property is generally treated as placed in service at the midpoint of the tax year

C. Mid-month convention, because the property was acquired in more than one calendar month during the year

D. Full-month convention, because the taxpayer may elect the convention that produces the smallest current-year deduction

52. Harbor Logistics purchased a five-year-old forklift from an unrelated dealer and placed it in service in its business this year. The taxpayer had never used or owned the forklift before, and the dealer is not related to Harbor Logistics under Section 267 or 707(b). For bonus depreciation purposes, how is this used forklift treated?

A. It does not qualify for bonus depreciation because bonus depreciation applies only to new property with no prior owner

B. It qualifies for bonus depreciation because the taxpayer's use is its first use of the property, and the purchase was not from a related party

C. It qualifies only if the taxpayer elects out of MACRS and instead uses the alternative depreciation system exclusively

D. It does not qualify because used property must be depreciated entirely under Section 179 rather than bonus depreciation

53. A business acquires new 5-year MACRS equipment during the year, fully eligible for 100% bonus depreciation. However, the business wants to spread its deduction over the regular MACRS recovery period instead of claiming the full bonus amount, in order to preserve larger deductions in future years. What must the business do to achieve this?

A. Make an irrevocable election out of bonus depreciation for the 5-year property class, applied on a class-by-class basis for the tax year.

B. Nothing is required; businesses may freely choose each year, without any election, whether to apply bonus depreciation to specific assets.

C. File an amended return within three years of the original filing, retroactively electing out of bonus depreciation for prior-year assets.

D. Obtain advance IRS consent through a private letter ruling before purchasing equipment intended to be excluded from bonus depreciation treatment.

54. A single taxpayer's taxable income before the QBI deduction is $150,000, which includes $10,000 of net capital gain. The taxpayer's combined qualified business income deduction, before applying the overall limitation, is computed at $35,000. What is the maximum QBI deduction the taxpayer may claim?

A. $35,000, because the tentative QBI deduction is never limited once it is properly computed under the wage and UBIA rules

B. $28,000, because the deduction cannot exceed 20% of taxable income reduced by net capital gain ($140,000 x 20%)

C. $30,000, because the deduction is capped at 20% of the taxpayer's total taxable income before any adjustments

D. $35,000, because net capital gain is added back, not subtracted, when calculating the overall taxable-income limitation

55. A business earns 8% of its gross receipts from a specified service trade or business (SSTB) activity, such as consulting, and the remaining 92% from a non-SSTB retail activity conducted as part of the same trade or business, with total gross receipts under $25 million. Under the QBI de minimis rule, how is this business treated?

A. The entire business must be split proportionally, with 8% of QBI treated as SSTB income and 92% treated as non-SSTB income.

B. The entire business is automatically treated as an SSTB, because any SSTB activity, however small, taints the whole trade or business.

C. The business must obtain IRS pre-clearance confirming its SSTB percentage before applying the de minimis exception in any tax year.

D. The entire business is treated as a non-SSTB, because SSTB gross receipts fall below the 10% de minimis threshold for businesses under $25 million.

56. A taxpayer's taxable income exceeds the fully phased-in threshold, so the QBI deduction for the business is limited to the greater of 50% of W-2 wages or 25% of W-2 wages plus 2.5% of unadjusted basis (UBIA) of qualified property. The business paid $120,000 of W-2 wages and holds $400,000 of UBIA in qualified property. What is the applicable wage/UBIA limitation?

A. $60,000, because 50% of W-2 wages always produces the correct final limitation regardless of UBIA

B. $40,000, because 2.5% of UBIA alone represents the entire statutory limitation once wages exceed a de minimis floor

C. $60,000, because 50% of wages ($60,000) exceeds 25% of wages plus 2.5% of UBIA ($30,000 + $10,000 = $40,000)
D. $70,000, because the two components of the limitation are always added together rather than compared

57. A corporation's general business credit for the current year exceeds the amount it can use due to the tax-liability limitation. After applying the current-year credit first, how may the corporation use any unused general business credit under Section 39?

A. Carry it back one year and then carry any remaining unused amount forward up to 20 years
B. Carry it back three years and then carry any remaining unused amount forward up to 15 years
C. Carry it forward indefinitely with no carryback allowed under current law
D. Forfeit the unused credit entirely because general business credits may not be carried to another tax year

58. A corporation computes a research credit under Section 41 but does not want to reduce its Section 174 research expense deduction by the amount of the credit claimed, as would normally be required to avoid a double tax benefit. What election allows the corporation to avoid reducing its deduction?

A. An election to use the Alternative Simplified Credit method instead of the regular research credit computation method
B. An election under Section 280C to claim a reduced research credit instead of reducing the research expense deduction
C. An election to capitalize and amortize all research expenditures over a mandatory five-year period under Section 174
D. An election to treat the research credit as a general business credit rather than a research-specific credit

59. A manufacturing company installs qualifying solar energy property costing $500,000 and claims a 30% energy investment credit of $150,000. For depreciation purposes, how must the company adjust the depreciable basis of the solar property?

A. The full $500,000 cost remains depreciable, because energy credits never require any basis reduction under current law

B. The basis must be reduced by the entire $150,000 credit amount, leaving only $350,000 of depreciable basis

C. The basis must be reduced by one-half of the credit amount, or $75,000, leaving $425,000 of depreciable basis

D. The basis must be increased by the credit amount to reflect the government's economic contribution to the project

60. A small business installs a new electric vehicle charging station at its warehouse, located in an eligible census tract, for use in its business. Which credit is designed to offset the cost of this qualified alternative fuel vehicle refueling property?

A. The Qualified Commercial Clean Vehicle Credit under Section 45W

B. The Investment Tax Credit for energy property under Section 48

C. The Advanced Manufacturing Production Credit under Section 45X

D. The Alternative Fuel Vehicle Refueling Property Credit under Section 30C

61. A retailer makes interior improvements to the inside of its leased retail building, not enlarging the building, not for elevators or escalators, and not for the building's internal structural framework. Under current MACRS rules, how is this qualified improvement property (QIP) depreciated, and is it eligible for bonus depreciation?

A. QIP is depreciated over 39 years like the underlying building, and is never eligible for bonus depreciation under any circumstance.

B. QIP is depreciated over 27.5 years as residential property, and is eligible for bonus depreciation only if placed in service after 2020.

C. QIP is depreciated over a 15-year MACRS recovery period and is eligible for bonus depreciation, since Congress corrected its recovery period retroactively.

D. QIP is treated identically to land improvements, depreciated over 20 years, and is permanently ineligible for any bonus depreciation election.

62. A partner in a consulting partnership receives a $60,000 guaranteed payment under Section 707(c) for services rendered to the partnership, in addition to her distributive share of ordinary business income. How is the guaranteed payment treated for purposes of the Section 199A qualified business income deduction?

A. It is included in QBI at 50% of its value, mirroring the treatment of reasonable compensation paid to S corporation shareholders

B. It is excluded from QBI entirely, in the same manner as reasonable compensation paid to an S corporation shareholder-employee

C. It is included in QBI in full, since partnerships are not subject to the same wage-exclusion rules as corporations

D. It is included in QBI only if the partnership is not engaged in a specified service trade or business

63. A business exchanges a delivery van it no longer needs for a similar delivery van of equal value owned by another company, with no cash changing hands. Both vans are used solely in each company's trade or business. Under current law, how is this exchange of personal property treated?

A. The exchange is fully taxable, because Section 1031 like-kind exchange treatment applies only to real property since the Tax Cuts and Jobs Act

B. The exchange qualifies for full nonrecognition treatment under Section 1031, identical to an exchange of real property

C. The exchange qualifies for partial deferral, with recognized gain limited to any boot received in the transaction

D. The exchange is treated as an involuntary conversion, deferring gain only if replacement property is purchased within two years

64. A qualifying small employer has 15 full-time equivalent employees, average annual wages below the statutory threshold, pays at least 50% of employee health insurance premiums, and purchases coverage through the SHOP Marketplace. Which credit may this employer be eligible to claim for the premiums paid?

A. The Work Opportunity Tax Credit, based on wages paid to employees enrolled in the health plan

B. The Employer-Provided Childcare Credit, based on premiums paid on behalf of qualifying dependents

C. The Credit for Small Employer Pension Plan Startup Costs, based on administrative fees for the health plan

D. The Small Employer Health Insurance Premium Credit under Section 45R, subject to phase-out based on employee count and average wages

65. A farming business places new 7-year MACRS farm equipment in service and does not make any special depreciation method election. Under Section 168(b)(2), what depreciation method must the farming business generally use for this property, in contrast to the 200% declining balance method available to most other businesses?

A. Straight-line method over the full recovery period, with no declining balance method permitted for any farm property

B. 150% declining balance method, switching to straight-line when it yields a larger deduction

C. 200% declining balance method, identical to the default method used by non-farming businesses for the same property class

D. Units-of-production method, based on the equipment's actual usage hours during the tax year

66. A restaurant employer pays the employer share of FICA taxes on tips its food-service employees report, including amounts exceeding what is needed to bring each employee's wages up to the federal minimum wage rate in effect on January 1, 2007. How may the employer treat these excess FICA taxes paid on reported tips?

A. As an above-the-line deduction claimed directly against gross receipts for the tax year

B. As additional wage basis added to each employee's Form W-2 taxable compensation amount

C. As a refund claimed only by filing an amended Form 941 for that quarter

D. As a general business credit available under Internal Revenue Code Section 45B

67. An employer operates solely in a state that has not repaid its federal unemployment insurance loan balance and is therefore designated a FUTA credit reduction state for the year. What effect does this designation have on the employer's Form 940 liability?

A. The employer's FUTA wage base increases from $7,000 to $9,000 for that year

B. The employer becomes ineligible to claim any FUTA credit and owes the full 6.0%

C. The employer's normal 5.4% FUTA credit is reduced, increasing net FUTA tax owed

D. The employer must instead remit unemployment tax directly to the federal Department of Labor

68. A sole proprietor purchased a car three years ago and has depreciated it under MACRS using an accelerated (200% declining balance) method for business use. This year she wants to switch to the standard mileage rate to compute her vehicle deduction. What governs whether she may make this switch?

A. She may not use the standard mileage rate because an accelerated MACRS method was used
B. She may freely switch each year regardless of the depreciation method previously claimed
C. She may switch only if she first recaptures all depreciation claimed in prior years
D. She may switch only with advance written IRS consent obtained before the tax year begins

69. An IRS examiner disallows a self-employed contractor's claimed vehicle mileage deduction because the contractor has only a rough year-end estimate of total business miles driven, with no log, calendar, or app data created during the year. Which principle best explains why the estimate alone is insufficient?

A. Vehicle expenses are listed property under Section 274(d) and require contemporaneous substantiation
B. The Cohan rule permits reasonable estimates for all business expenses, including vehicle mileage
C. Vehicle mileage deductions are disallowed entirely unless a dealer-installed GPS tracker is used
D. Estimates are acceptable only when the taxpayer's total business mileage exceeds 10,000 miles

70. A taxpayer operates a licensed in-home daycare business and uses her living room, kitchen, and playroom for both the daycare and personal family purposes during non-business hours. Which statement correctly describes how she may still qualify for a home office deduction despite this mixed use?

A. She may not qualify because daycare rooms must be used exclusively for business at all times
B. She must convert to the simplified method, since regular-method deductions require exclusive-use spaces only
C. She may deduct expenses only for a single room used exclusively and permanently as an office
D. Licensed daycare providers qualify under a specific exception to the exclusive-use test, using time-space percentage

71. A firm is uncertain whether several long-term workers should be classified as employees or independent contractors and, rather than continuing to guess, files Form SS-8 with the IRS requesting an official worker-status determination. Which statement correctly describes the effect of this filing?

A. The determination automatically applies retroactively to reclassify the workers for all prior open years

B. Filing Form SS-8 immediately suspends the firm's obligation to deposit any employment taxes pending review

C. The IRS determination addresses federal employment tax status only and does not bind other agencies

D. Either party filing Form SS-8 guarantees the worker will be classified as a common law employee

72. A corporation obtains its EIN and hires its first employees partway through its first calendar year, having accumulated no employment tax liability in the applicable lookback period because none existed. Under the deposit rules, what deposit schedule applies to this new employer for that first year?

A. Semiweekly, because new employers are presumed to have significant payroll liability

B. Monthly, because a new employer with no lookback history is treated as a monthly depositor

C. Annual, because first-year employers may defer all deposits until Form 941 is filed

D. The employer selects either schedule freely, with no default rule applying in year one

73. A business purchased commercial real property many years ago and has claimed depreciation on it every year since. For how long should the business generally retain the records establishing the property's original cost basis and subsequent capital improvements?

A. For as long as needed to figure the basis of the property, plus the period after disposal

B. For three years from the filing date of the return reporting the year of purchase only

C. For four years from the date the related employment tax deposits were originally due

D. For six years from the date the property was fully depreciated under its MACRS schedule

74. A calendar-year employer made every required FUTA deposit for the year in full and on time. Under this circumstance, what is the extended due date allowed for filing the employer's Form 940 for that year, instead of the normal January 31 deadline?

A. March 15, matching the original due date for calendar-year partnership and S corporation returns

B. February 10, an automatic ten-day extension granted for timely full-year FUTA depositors

C. April 15, matching the individual income tax filing deadline for that calendar year
D. No extension applies; Form 940 is always due January 31 regardless of deposit timeliness

75. A firm treats a group of workers as independent contractors, has a reasonable basis for doing so, but did not act willfully or with intentional disregard of the reporting rules. If the IRS later reclassifies these workers as employees, what does Section 3509 provide for the firm's resulting liability?

A. The firm becomes liable for the full uncapped employee and employer shares of FICA and income tax withholding
B. The firm is assessed the trust fund recovery penalty against each individual officer determined to be responsible
C. Section 3509 provides reduced, favorable assessment rates for the employer's resulting liability in this situation
D. Section 3509 eliminates the firm's liability entirely once reasonable basis for the classification is shown

76. A sole proprietor leases a car for business use and, in the first year the vehicle is available for use, elects to compute her vehicle deduction using the standard mileage rate rather than actual expenses. What restriction applies to her for the remainder of the lease term?

A. She may switch freely between the standard mileage rate and actual expenses each later year
B. She may switch to actual expenses only after obtaining written IRS consent for the change
C. She must depreciate the leased vehicle under MACRS beginning in the second year of the lease
D. She must use the standard mileage rate for all remaining years the lease is in effect

77. A taxpayer's home office qualifies for the deduction and measures 400 square feet, well above the 300-square-foot cap that applies under the simplified home office method. If she elects the simplified method anyway, how is the deduction affected, and what happens to expenses attributable to the excess 100 square feet?

A. The deduction is computed on the full 400 square feet, with no cap applied at all
B. The 400 square feet disqualifies her entirely, forcing her to use only the regular method
C. The deduction is capped at 300 square feet, and no carryover of the excess is allowed

D. The excess 100 square feet may be carried forward and deducted in a later tax year

78. A worker sells consumer products door-to-door on a commission basis, is compensated almost entirely based on sales rather than hours worked, and performs services under a written contract stating she will not be treated as an employee for federal tax purposes. Under what category might she be classified for employment tax purposes?

A. A common law employee, because commission-based direct selling always indicates employer behavioral control
B. A statutory nonemployee, if the direct-seller conditions under the Internal Revenue Code are satisfied
C. A statutory employee, subject to FICA withholding but not federal income tax withholding
D. A leased employee, subject to FICA withholding through the client company's payroll system

79. A small employer's total employment tax liability for the current calendar quarter is $1,900, below the $2,500 quarterly de minimis threshold, and the employer did not accumulate $100,000 or more of liability on any single day during the quarter. How may this employer satisfy its deposit obligation for the quarter?

A. The employer must still deposit electronically through EFTPS within three banking days of each payday
B. The employer must obtain IRS pre-approval before choosing not to make periodic electronic deposits
C. The employer must follow its assigned monthly or semiweekly schedule regardless of the small balance
D. The employer may simply remit the full amount with its timely filed quarterly Form 941

80. A domestic complex trust has $550 of gross income and $200 of taxable income for the tax year, with no nonresident alien beneficiaries. Under the Form 1041 filing requirements, which statement is correct?

A. The trust must file Form 1041 because it has taxable income for the year, even though its gross income is below $600.
B. The trust need not file Form 1041 because its gross income is below the $600 threshold.
C. The trust must file Form 1041 only if it distributes income currently to its beneficiaries.

D. The trust need not file Form 1041 unless it has a nonresident alien beneficiary during the year.

81. An executor and the trustee of a decedent's revocable trust wish to combine the trust's activity with the estate's for income tax reporting purposes, filing a single Form 1041 rather than two separate returns. Which election allows this treatment?

A. The check-the-box election made under Treasury Regulations Section 301.7701-3.
B. The alternate valuation election made available under Section 2032 rules.
C. The qualified disclaimer election made available under Section 2518 rules.
D. The Section 645 election for qualified revocable trusts joining the estate's return.

82. A trust has two beneficiaries with economically independent interests in different portions of trust corpus, and the trustee distributes income unevenly between them during the year. Which rule requires distributable net income to be allocated as if each beneficiary's interest were a separate trust?

A. The separate share rule.
B. The throwback rule.
C. The tier system rule.
D. The 65-day rule.

83. A grantor establishes an irrevocable trust whose governing instrument directs the trustee to use trust income, without the consent of any adverse party, to pay premiums on a life insurance policy insuring the grantor's own life. What is the income tax consequence?

A. The trust is treated as a complex trust taxed on the income used for premiums.
B. The trust income is treated as a nondeductible personal expense of the beneficiaries.
C. The grantor is taxed on that trust income under the grantor trust rules.
D. The trust income is exempt from tax because life insurance premiums are not income items.

84. A tax-exempt trade association publishes a periodical for its members and sells advertising space to unrelated businesses within its pages. The advertising is not substantially related to the association's exempt purpose. How is the net advertising income generally treated?

A. It is fully excluded from unrelated business taxable income as a member communication.
B. It is included in unrelated business taxable income as advertising unrelated to the exempt purpose.
C. It is excluded because periodicals distributed only to members are never subject to UBIT.
D. It is treated as a tax-exempt royalty rather than as business income.

85. A tax-exempt organization fails to file any required annual return or notice (Form 990, 990-EZ, or 990-N) for three consecutive tax years. What is the automatic consequence under current law?

A. The organization's tax-exempt status is automatically revoked as of the filing due date for the third year.
B. The organization is assessed a flat monetary penalty but retains its exempt status permanently.
C. The organization is automatically reclassified as a private foundation regardless of its prior status.
D. The organization is required to convert to a for-profit entity within twelve months.

86. An individual owns 100% of two separate businesses, a retail store and a consulting firm, each maintaining its own qualified retirement plan. For purposes of minimum coverage and nondiscrimination testing, how are the two businesses treated?

A. Each business is tested entirely independently because they operate in unrelated industries.
B. The businesses are combined only if they share the same physical location.
C. The businesses are combined only if total combined employees exceed fifty.
D. The businesses are treated as a single controlled group employer for testing purposes.

87. A 401(k) plan's average elective deferral percentage for highly compensated employees exceeds the maximum spread allowed over the deferral percentage of non-highly compensated employees. Which nondiscrimination test has the plan failed?

A. The top-heavy minimum contribution test.
B. The minimum coverage ratio percentage test.
C. The actual deferral percentage (ADP) test.
D. The permitted disparity integration test.

88. A farmer pays $18,000 during the year for soil and water conservation expenditures consistent with an approved conservation plan. The farmer's gross income from farming for the year is $60,000. What is the maximum current-year deduction allowed under Section 175?

A. $18,000, the full amount paid, with no percentage limitation.
B. $15,000, limited to 25% of gross income from farming.
C. $6,000, limited to 10% of gross income from farming.
D. $9,000, limited to 50% of gross income from farming.

89. A married farmer filing jointly has aggregate business deductions from farming that exceed aggregate business gross income and gains by an amount above the applicable excess business loss threshold for the year. What happens to the disallowed excess business loss?

A. It is permanently disallowed and provides no future tax benefit.
B. It must be carried back two years against prior farm income.
C. It reduces the farmer's basis in farm assets instead of being deducted.
D. It is treated as a net operating loss carryforward to future tax years.

90. A taxpayer participates in a business activity for 140 hours during the year without meeting any material participation test based on that involvement alone, and also has other similar activities with comparable participation levels. Under the passive activity regulations, how is an activity with participation between 100 and 500 hours, without independently meeting another test, generally classified?

A. It is automatically treated as an active trade or business exempt from passive rules.
B. It is a significant participation activity, aggregated with other such activities for testing.
C. It is automatically reclassified as investment income rather than business income.
D. It is disregarded entirely for passive activity loss computation purposes.

91. A taxpayer contributes $10,000 cash and property with an adjusted basis of $8,000 to a business activity, and separately borrows $5,000 on a recourse basis for which the taxpayer is personally liable, investing it in the same activity. What is the taxpayer's amount at risk in the activity?

A. $23,000, the sum of cash contributed, adjusted basis of property, and personally liable borrowed funds.

B. $18,000, excluding any amounts financed through personal borrowing.

C. $15,000, counting only the cash and the borrowed recourse funds.

D. $10,000, counting only the cash contribution to the activity.

92. A taxpayer invests in rental real estate financed partly through nonrecourse debt secured by the real property itself and borrowed from a bank unrelated to the taxpayer, with commercially reasonable terms. How does this nonrecourse financing generally affect the taxpayer's at-risk amount?

A. It is entirely excluded from the at-risk amount because nonrecourse debt is never at risk.

B. It increases the at-risk amount only if the taxpayer also personally guarantees repayment.

C. It increases the at-risk amount because qualified nonrecourse financing for real property is an exception.

D. It reduces the taxpayer's at-risk amount by the full amount of the debt incurred.

93. A taxpayer owns several business operations and wants to combine them into a single unit for purposes of applying the material participation and passive activity loss rules, rather than testing each operation separately. Which factor is most relevant to whether such activities may be grouped together?

A. Whether the activities constitute an appropriate economic unit based on similarities and business connections.

B. Whether the activities are all conducted using the same accounting method.

C. Whether the activities generate exactly equal amounts of gross receipts each year.

D. Whether the activities were acquired by the taxpayer in the same calendar year.

94. A tax-exempt parent organization receives rent from a taxable subsidiary corporation in which it owns more than 50% of the voting stock. Under the special controlled-entity rule, how is this rental income generally treated for unrelated business income tax purposes?

A. It is fully excluded from unrelated business taxable income under the general rent exclusion.

B. It is excluded automatically because payments between related parties are never taxable.

C. It is included in unrelated business taxable income to the extent it reduces the subsidiary's taxable income.

D. It is treated as a tax-exempt dividend rather than as rental income.

95. A qualified retirement plan participant who is not a 5% owner of the sponsoring employer continues working past the plan's normal retirement age. Assuming the plan permits it, when must the participant's required beginning date for minimum distributions occur?

A. April 1 of the year after the participant reaches the applicable RMD age, regardless of employment status.

B. April 1 of the year after the participant actually retires, if later than the applicable RMD age.

C. December 31 of the year the participant reaches the applicable RMD age, with no delay permitted.

D. April 1 of the year the participant reaches the applicable RMD age, without exception.

96. A private non-operating foundation must distribute a minimum amount for charitable purposes each year, calculated as a percentage of the foundation's noncharitable-use assets, or face an excise tax on the undistributed amount. What is this required minimum distribution percentage under Section 4942?

A. 2% of the foundation's net investment income for the year, regardless of the foundation's asset base.

B. 10% of the foundation's gross receipts from all sources, including both charitable and investment activities.

C. 30% of the foundation's total assets, valued at fair market value as of the last day of the tax year.

D. 5% of the foundation's average fair market value of noncharitable-use assets, reduced by certain deductions.

97. A farmer pledges stored grain as collateral for a Commodity Credit Corporation loan and wants to report the loan proceeds as income in the year received rather than waiting until the commodity is later sold or forfeited. Which provision permits this treatment?

A. Section 108, discharge of indebtedness income.

B. Section 175, soil and water conservation expenses.

C. Section 77, the election to treat CCC loan proceeds as income.

D. Section 1301, farm income averaging.

98. A national tax-exempt organization has numerous local chapters, each performing the same type of charitable activity under the national organization's general supervision and control. Rather than each chapter separately applying for its own exemption determination, what mechanism allows the chapters to be recognized as tax-exempt together?

A. A group exemption ruling obtained by the central organization on behalf of subordinate chapters.

B. A private letter ruling issued individually to each local chapter every year.

C. A blanket Form 1023-EZ filing covering all chapters under one employer identification number.

D. Automatic recognition without any application, available only to organizations with chapters nationwide.

99. A qualified retirement plan has 130 participants with account balances at the beginning of the plan year. Which additional requirement generally applies to this plan's Form 5500 filing that would not apply to a small plan with fewer participants?

A. The plan must file Form 5500-EZ instead of the standard Form 5500.

B. The plan is exempt from filing any annual return with the Department of Labor.

C. The plan must obtain a determination letter from the IRS every year.

D. The plan generally must include an independent qualified public accountant's audit report.

100. A complex trust has $15,000 of undistributed net investment income for the year. The trust's undistributed taxable income also exceeds the top income tax bracket threshold for trusts and estates. How is the 3.8% net investment income tax applied?

A. It applies to the trust's entire gross income regardless of the amount distributed to beneficiaries.

B. It applies to the lesser of undistributed net investment income or the excess of AGI over the threshold.

C. It never applies to trusts because the tax is limited to individual taxpayers only.

D. It applies only if the trust is a grantor trust taxed directly to the grantor.

Answer Key and Explanations — Practice Exam 20, Part 2: Businesses

1. C — Section 709(b) allows a $5,000 first-year deduction for organizational expenses, but that amount is reduced dollar-for-dollar by the excess over $50,000. Here, $52,000 exceeds $50,000 by $2,000, cutting the deduction to $3,000. The remaining $49,000 is amortized ratably over 180 months beginning when the partnership starts business, not deducted immediately or capitalized indefinitely.

2. B — Section 705(a)(1)(B) requires a partner's outside basis to increase by her distributive share of partnership tax-exempt income, even though that income is never taxed. This prevents double taxation: without the basis increase, a later cash distribution of the tax-exempt earnings would trigger gain under Section 731(a) despite already being tax-free income.

3. D — Under Section 732(b), when a distribution liquidates a partner's entire interest, her basis in property received (other than money) equals her outside basis immediately before the distribution, reduced by any money also received. Since Wren received only land and no cash, her substituted basis in the land is her full $90,000 outside basis, regardless of the partnership's lower inside basis.

4. A — When an allocation lacks economic effect entirely, Section 704(b) and its regulations require reallocation according to the partners' interests in the partnership (PIP). PIP is determined by weighing all facts and circumstances, including relative capital contributions, historical profit and loss sharing ratios, tax consequences of the allocation, and each partner's economic interest, not by a single mechanical factor.

5. A — Net earnings from self-employment under Section 1402(a) include only income derived from actively carrying on a trade or business, not gains or losses from the sale of business property. Because Talia's $12,000 Section 1231 gain is a property disposition rather than income from operations, it is excluded entirely from her SE tax base, even though it is business-related.

6. D — Under the BBA regime, the partnership designates a single partnership representative with sole authority to act on its behalf and bind all partners in an IRS proceeding, whether or not that representative is itself a partner. This replaced TEFRA's tax matters partner, under which individual partners retained separate notice and participation rights the current regime eliminated.

7. C — A partnership terminates under Section 708(b)(1) whenever no part of its business continues to be carried on by any of its partners in partnership form. Because a single buyer now owns the entire business, there are no longer two or more partners, so the entity cannot continue as a partnership for tax purposes and terminates immediately upon the sale.

8. B — A donee is recognized as a bona fide partner under Section 704(e) only if the transfer is genuine and the donee actually owns the interest, exercising real control and enjoying its economic benefits. Where a parent keeps unilateral power to redirect income or revoke the gift, the IRS disregards the child as owner, denying bona fide partner status.

9. C — Section 465(b)(4) excludes from a taxpayer's amount at risk any amount protected against loss through nonrecourse financing, guarantees, stop-loss agreements, or similar arrangements, even if the underlying contribution was cash. Because $20,000 of Owens's $30,000 contribution is insured against loss, her at-risk amount is reduced to $10,000, the portion genuinely exposed to economic risk.

10. D — Guaranteed payments are generally deductible business expenses under Section 707(c), but they remain subject to normal tax accounting rules. A guaranteed payment made for services that facilitate acquiring a capital asset, such as a building the partnership will use for years, must be capitalized as part of the asset's basis rather than deducted immediately in the year paid.

11. B — Section 705(a)(2)(B) requires a partner's outside basis to decrease by her distributive share of partnership expenditures that are neither deductible nor properly chargeable to a capital account, such as most fines and penalties. Even though the $15,000 penalty produces no deduction, Reyes's basis still falls by her $3,000 share, preventing an artificial basis increase from an economic outflow.

12. A — Section 164(f) allows a self-employed taxpayer to deduct one-half of self-employment tax in arriving at adjusted gross income, but this is strictly an income tax deduction. It does not feed back into or reduce net earnings from self-employment, which is computed independently by applying the 92.35% factor to net profit before any income tax deductions are considered.

13. A — Under Section 1223(1), when a partner contributes a capital asset or Section 1231 property in exchange for a partnership interest in a nonrecognition transaction, the holding period of the partnership interest includes, or tacks, the holding period of the contributed property. Because Yun held the land as an investment asset for six years, that period carries over directly.

14. C — A partnership is not treated as terminated the instant its active business ceases. Under the regulations interpreting Section 708, the partnership continues in existence throughout a reasonable winding-up period, during which it collects receivables, pays creditors, and distributes remaining assets. Termination occurs when winding up is complete, here June 30, not on the earlier date operations stopped.

15. D — Section 735 provides that gain on the disposition of distributed inventory items remains ordinary income if the distributee partner sells the property within five years of the distribution, regardless of how the property might otherwise be classified in the partner's hands. This prevents partners from converting ordinary partnership income into capital gain merely by distributing inventory first.

16. B — Section 704(e) recognizes a family member as a partner where capital is a material income-producing factor if she is the real owner of the capital interest. A bona fide purchase for full and adequate consideration, paid with the buyer's own funds, establishes ownership and avoids the heightened scrutiny applied to gifted interests, where donor control and reasonable compensation issues arise.

17. C — Section 465(c) generally treats each trade or business activity separately for at-risk purposes, but allows a taxpayer to aggregate two or more trades or businesses into a single activity if she actively participates in managing each one. Because this individual actively manages both the nursery and the landscaping operation, she may combine them for computing her at-risk amount.

18. D — Section 6225(c) allows a partnership to request modification of an imputed underpayment before it is finalized, based on factors such as partners who are tax-exempt entities not subject to the adjustment, or reviewed-year partners filing amended returns and paying their own share. This modification process can meaningfully reduce the default imputed underpayment computed at the highest applicable tax rate.

19. B — Because Wanda controls both corporations, the cash sale does not meaningfully reduce her interest in either one. Section 304 recharacterizes a stock sale between commonly controlled corporations as a redemption tested under Section 302 principles. Failing exchange treatment, the proceeds are taxed as a dividend to the extent of Bishop's and Falcon's combined earnings and profits.

20. A — Section 368(a)(1)(G) defines this fact pattern precisely: a transfer of a debtor corporation's assets to another corporation in a Title 11 or similar court proceeding, with the acquiring corporation's stock distributed in a transaction qualifying under Sections 354, 355, or 356. It is distinct from an A merger because a formal court-supervised bankruptcy plan governs the exchange.

21. B — A corporation meeting both the stock-ownership test (five or fewer individuals own more than 50%) and the income test (at least 60% adjusted ordinary gross income is passive-type personal holding company income) risks the personal holding company tax. This 20% tax applies to undistributed personal holding company income, penalizing corporations that accumulate passive income instead of distributing it as dividends.

22. A — Courts, including Renkemeyer, have held that an LLC member who does not manage or provide services, and functions like a passive investor, may qualify for the limited partner exception under Section 1402(a)(13), excluding that distributive share from self-employment earnings. Members who actively manage or provide substantial services generally cannot rely on this exception, unlike Marcus.

23. D — Unlike individuals, C corporations receive no preferential rate for long-term capital gains. Net capital gains are simply included in taxable income and taxed at the corporation's regular flat corporate rate. Corporations may, however, use capital losses only to offset capital gains, and unused losses carry back three years and forward five years rather than offsetting ordinary income.

24. C — Section 291 applies only to C corporations and requires 20% of the amount that would have been Section 1245 ordinary income recapture, had the property been Section 1245 property, to be recaptured as additional ordinary income beyond what Section 1250 alone would require. This corporate-specific rule increases ordinary income and correspondingly reduces the Section 1231 gain reported by Regal Corp.

25. B — Section 243 grants a corporate shareholder a 100% dividends-received deduction when it owns at least 80% of the vote and value of the distributing corporation's stock, meeting the affiliated-group ownership threshold, even absent a consolidated election. Below 80% but at least 20%, the deduction is generally 65%; below 20% ownership, only 50% of the dividend is deductible under current law.

26. C — Under Reg. Section 1.1367-2, shareholder open account debt to an S corporation is combined and adjusted for basis like a single debt during the year, but once the outstanding balance exceeds $25,000 at year-end, it instead is treated as evidenced by a separate written instrument, so later advances and repayments are analyzed as bona fide indebtedness, not open account activity.

27. D — Section 336(d)(1) disallows a liquidating corporation's loss on property distributed to a related person, as defined under Section 267, when the distribution is non-pro rata among shareholders, or the property was acquired in a tax-avoidance contribution within the prior five years. Because this distribution is non-pro rata to a majority shareholder, Crest Corp's built-in loss is disallowed entirely.

28. A — Rev. Rul. 84-111 describes three methods for converting a partnership or LLC into a corporation: assets-over, assets-up, and interests-over. When the entity itself contributes assets and liabilities directly to the new corporation for stock and then liquidates by distributing that stock, this is the assets-over method, the default form generally respected by the IRS and typically qualifying under Section 351.

29. C — A QSST passes S corporation income through to its single current income beneficiary, treated as owner of that trust portion for tax purposes. An ESBT, by contrast, permits multiple beneficiaries but is itself taxed on the S corporation income allocable to that portion, generally at the highest trust income tax rate, rather than passing income through to beneficiaries directly.

30. B — Under Section 1368, a cash distribution from an S corporation with no accumulated earnings and profits first reduces the shareholder's stock basis tax-free. Any amount beyond that adjusted basis is gain from a sale or exchange of stock, generally capital gain, rather than a dividend, since the corporation has no earnings and profits available to support dividend treatment.

31. D — Section 1563(a) treats controlled group members as a single entity for the minimum accumulated earnings credit, so the group as a whole is limited to one $250,000 credit (or $150,000 for certain service corporations). Members apportion this single credit among themselves, either by written consent or, absent agreement, in equal shares under the statute's default allocation rule.

32. A — Section 1361(c)(5) provides a straight debt safe harbor: a written unconditional promise to pay a fixed sum on demand or a specified date, with interest not contingent on profits and not convertible into stock, held by an eligible individual, estate, or certain trust, avoids treatment as a second class of stock, preserving the S election.

33. B — Section 357(c) generally does not disqualify the exchange, but requires the transferor to recognize gain when liabilities assumed by the corporation exceed the transferor's total adjusted basis in the transferred property. Here, liabilities of $65,000 exceed Ken's $40,000 basis by $25,000, so Ken recognizes $25,000 of gain, even though the transfer otherwise qualifies under Section 351's control requirement.

34. C — Reg. Section 301.7701-3(c)(1)(iv) generally bars an eligible entity from changing its classification election again within 60 months of an earlier election's effective date, absent an exception such as a more than 50% ownership change or IRS consent via private letter ruling. This limits the members' ability to revert to partnership treatment so soon after electing corporate status.

35. D — Section 351(e) denies nonrecognition when property goes to an investment company, meaning a corporation where the transfer diversifies the transferors' interests and over 80% of its assets are readily marketable stocks, securities, or similar assets. Pooling diversified securities this way causes each transferor to recognize gain on the exchange, despite otherwise meeting the control requirement.

36. A — Under the constructive receipt doctrine, income is taxable once it is credited, set apart, or otherwise made available so the taxpayer can draw on it without substantial restriction, regardless of actual possession. Because the check sat unrestricted in the mailbox on December 30, the proprietor constructively received the funds in 2025; delaying retrieval to January does not defer the income.

37. C — Under IRC Section 706(b), a partnership generally must adopt the tax year of its majority-interest partners—those owning more than 50% of partnership profits and capital. Because Ray alone owns 55% and reports on a calendar year, RayCo must adopt a calendar year, regardless of the other partners' fiscal year, unless a business purpose exception or Section 444 election applies.

38. B — When an accounting method change is imposed by the IRS on examination (an involuntary change), the entire Section 481(a) adjustment is generally included in taxable income in the single year of change, with no multi-year spread. This differs from a voluntary, taxpayer-initiated change, where a net positive adjustment is normally spread ratably over four tax years.

39. D — Section 267(a)(2) prevents mismatching between related accrual- and cash-method taxpayers: an accrual-method payor may not deduct an expense owed to a related cash-method payee until the amount is actually paid and includible in the payee's income. Because Bexley's majority shareholder is a related cash-method party not paid until March 2026, Bexley's deduction is deferred until 2026.

40. A — IRC Section 453(b)(2)(A) excludes dealer dispositions of personal property from installment reporting, and Section 453(l) similarly denies installment reporting for dealers in real property who sell property held for sale to customers in the ordinary course of business. Because Dalton regularly subdivides and sells lots as inventory, his gain must be reported in full in the year of sale.

41. B — Under IRC Section 453(i), depreciation recapture under Sections 1245 or 1250 is recognized in full as ordinary income in the year of sale, even though the installment method otherwise defers gain as payments are collected. Only gain exceeding the recapture amount qualifies for installment reporting, so Marlowe must include the entire $60,000 recapture amount in the year of sale.

42. C — Section 448 generally bars C corporations and partnerships with a C corporation partner from using the cash method of accounting. However, Section 448(c) provides an exception for taxpayers, including C corporations, whose average annual gross receipts for the three preceding tax years do not exceed the inflation-adjusted threshold, currently well above $22 million, allowing continued cash-method use.

43. D — Under the deferral method for advance payments (IRC Section 451(c)), a business may defer income recognized in the year of receipt to the extent recognized in revenue for financial statement purposes, but only for one additional year. The business recognized $2,000 in 2025, so the remaining $22,000 cannot be deferred further and must be included in gross income by 2026.

44. A — Section 448(d)(5) permits qualifying service businesses in fields such as health, law, engineering, and consulting, that do not charge interest or penalties for late payment, to use the non-accrual experience (NAE) method. This method lets the business exclude from income the portion of accrued receivables that its experience shows will not be collected, rather than deducting them as bad debts.

45. A — Under Treasury Regulation Section 1.446-1(e), correcting an isolated mathematical or posting error that misapplies an otherwise consistently used accounting method is treated as an error correction, not a change in accounting method. Because the omission was a one-time posting mistake and the business's overall accrual method was applied correctly and consistently, no Form 3115 or IRS consent is required.

46. C — Section 263A generally requires taxpayers to capitalize direct and indirect costs allocable to property produced or acquired for resale. However, a small business taxpayer exception exempts taxpayers whose average annual gross receipts for the three preceding tax years do not exceed the inflation-adjusted threshold, currently indexed well above prior smaller thresholds, from the UNICAP capitalization requirement entirely.

47. D — Automatic accounting method changes, listed in the applicable revenue procedure, do not require advance IRS consent or a user fee. The taxpayer files Form 3115, attaching a copy to its timely filed return for the year of change and sending a duplicate to the IRS. This differs from non-automatic changes, which require advance consent and payment of a user fee.

48. B — IRC Section 441(f) permits a taxpayer to elect a 52-53-week tax year that always ends on the same specified day of the week closest to, or last occurring in, a chosen calendar month, such as the last Saturday in January. This differs from a standard fiscal year, which always ends on the same fixed calendar date each year.

49. C — Under IRC Section 453B(a), a taxable disposition of an installment obligation, including a gift (other than a transfer to a spouse, incident to divorce, or at death), triggers immediate gain recognition equal to the difference between the obligation's fair market value and the seller's basis. Priya must recognize the $60,000 difference between the $100,000 note and her $40,000 basis.

50. D — Under the crop method of accounting, available to farmers whose crops take more than one year from planting to harvest, the entire cost of raising the crop, including seed, fertilizer, and cultivation expenses, is deducted in the year the crop's income is realized, rather than in the year the costs are actually paid, matching income with its related expenses.

51. A — The mid-quarter convention applies when more than 40% of a year's total depreciable basis (here, $210,000 of $350,000, or 60%) is placed in service during the last quarter. Once triggered, it applies to all MACRS personal property placed in service that year, not just fourth-quarter assets. The half-year convention is the default only when this 40% test is not met.

52. B — Since 2018, bonus depreciation under Section 168(k) no longer requires original use by the taxpayer; used property qualifies if it is the taxpayer's first use of that property, was acquired from an unrelated party in an arm's-length purchase, and was not acquired from a related party or in a carryover-basis transaction. Harbor Logistics' forklift purchase satisfies these requirements and qualifies.

53. A — Bonus depreciation under Section 168(k) applies automatically to all qualifying property unless the taxpayer affirmatively elects out. The election is made on a class-by-class basis for each tax year, applying to all property within that recovery period class, and once made for a given year and class, the election is irrevocable without IRS consent.

54. B — The QBI deduction can never exceed 20% of the taxpayer's taxable income for the year, computed before the QBI deduction and reduced by net capital gain, including qualified dividends. Here, $150,000 taxable income minus $10,000 net capital gain equals $140,000; 20% of that is $28,000, which is lower than the $35,000 tentative amount, so $28,000 governs the final deduction.

55. D — Under the QBI de minimis rule, a business with gross receipts of $25 million or less is not an SSTB if less than 10% of receipts come from SSTB services, with a stricter 5% threshold above $25 million. Because this business's SSTB receipts are only 8%, below the threshold, the entire business qualifies as a non-SSTB.

56. C — The wage/UBIA limitation equals the greater of 50% of W-2 wages, or 25% of W-2 wages plus 2.5% of UBIA of qualified property. Here, 50% of $120,000 is $60,000, while 25% of $120,000 plus 2.5% of $400,000 equals $30,000 plus $10,000, or $40,000. Because $60,000 is greater, it becomes the applicable wage/UBIA limitation for the QBI deduction this year.

57. A — Under Section 39, an unused general business credit is first carried back one year, and any amount still unused after the carryback is carried forward up to 20 years. Credits are applied in a statutory order, oldest first, and if any credit remains unused after the carryforward period, it may be deducted as a business expense in a later year.

58. B — Section 280C(c) normally requires taxpayers claiming the research credit to reduce their deductible research expenses by the credit amount, avoiding a double tax benefit. A corporation may instead elect a reduced research credit, computed using a lower statutory rate, and keep its full research expense deduction. This election must be made on a timely filed original return and is irrevocable.

59. C — Section 50(c) requires a taxpayer claiming an energy investment credit to reduce the depreciable basis of the property by one-half of the credit amount, not the full amount. Here, half of the $150,000 credit is $75,000, so depreciable basis is reduced from $500,000 to $425,000. This partial reduction distinguishes the energy credit's basis rule from credits requiring full basis reduction.

60. D — Section 30C provides a credit for the cost of qualified alternative fuel vehicle refueling property, including electric vehicle charging equipment, placed in service in an eligible low-income or non-urban census tract. For business property, the credit generally equals 6% of cost, or up to 30% if prevailing wage and apprenticeship requirements are met, subject to a per-item dollar cap.

61. C — Qualified improvement property, meaning certain interior nonstructural improvements to nonresidential building interiors, was intended to have a 15-year MACRS recovery period, but a drafting error in the Tax Cuts and Jobs Act initially assigned it a 39-year period, also disqualifying it from bonus depreciation. The CARES Act retroactively corrected this drafting error, restoring the 15-year period and bonus eligibility.

62. B — Guaranteed payments for services under Section 707(c) are specifically excluded from qualified business income, just as reasonable compensation paid to an S corporation shareholder-employee is excluded. Both payment types compensate an owner for labor rather than a return tied to the trade or business's net income, so Congress excluded them from the QBI computation to prevent inflating the deduction amount.

63. A — The Tax Cuts and Jobs Act limited Section 1031 like-kind exchange treatment to real property only, for exchanges completed after 2017. Personal property, such as vehicles and equipment, no longer qualifies for nonrecognition treatment, so exchanging one delivery van for another is now a fully taxable transaction, with gain or loss recognized based on fair market value versus adjusted basis.

64. D — Section 45R provides a credit of up to 50% of premiums paid, or 35% for tax-exempt employers, by qualifying small employers with fewer than 25 full-time equivalent employees and average annual wages below an inflation-adjusted threshold, provided coverage is purchased through the SHOP Marketplace. The credit phases out as employee count and average wages rise toward the applicable statutory limits.

65. B — Section 168(b)(2)(B) requires property used in a farming business to be depreciated using the 150% declining balance method, switching to straight-line in the year that produces a larger deduction, rather than the 200% declining balance method generally available for other qualifying MACRS property. This rule applies unless the taxpayer elects straight-line depreciation or the alternative depreciation system instead of MACRS.

66. D — Section 45B provides employers a general business credit equal to the employer share of FICA taxes paid on tips exceeding the amount needed to reach the 2007 federal minimum wage rate. This encourages accurate tip reporting without denying the employer a separate wage deduction. It is a tax credit, not a Form 941 refund claim or added employee wage basis.

67. C — When a state has outstanding federal unemployment loan balances beyond the repayment window, it is designated a credit reduction state, and the employer's normal 5.4% FUTA credit is reduced, typically by 0.3% per year outstanding. This raises the effective net FUTA rate above the usual 0.6%, but it does not eliminate the credit entirely or change the wage base.

68. A — The standard mileage rate is unavailable for a vehicle once depreciation has been claimed using a method other than straight-line, including accelerated MACRS, or after claiming Section 179 or bonus depreciation on that vehicle. Because she used 200% declining balance, she is permanently barred from the standard mileage rate for this car; no consent or recapture restores eligibility.

69. A — Passenger vehicles are listed property under Section 274(d), which imposes strict substantiation requirements: amount, time, place, and business purpose, documented through adequate records or corroborating evidence created at or near the time of use. Courts have held the Cohan estimation rule does not override Section 274(d) for listed property, so a rough after-the-fact estimate cannot support the deduction.

70. D — Section 280A(c)(4) provides a specific exception to the exclusive-use requirement for taxpayers operating a licensed daycare facility, allowing rooms used for both daycare and personal purposes to qualify. The deductible portion is computed using a time-space percentage reflecting the hours the area is actually used for daycare relative to total hours available, rather than requiring dedicated, exclusively business space.

71. C — An IRS determination issued in response to Form SS-8 addresses the worker's status for federal employment tax purposes only; it does not automatically bind state agencies, other federal programs, or resolve related questions like fringe benefit eligibility. It also does not guarantee a particular outcome, suspend ongoing deposit obligations, or automatically apply retroactively without further IRS action.

72. B — Because a new employer has no employment tax liability reported during the lookback period (the second preceding calendar year), the regulations default that employer to the monthly deposit schedule for its first year of operation. The employer's schedule for later years is then determined normally by its actual lookback-period liability, not by an annual option or an automatic semiweekly presumption.

73. A — Basis records are an exception to the general three-year retention period. They must be kept for as long as they are material in determining the basis of the property, plus the retention period applicable to the year in which the property is eventually disposed of, since basis affects gain or loss calculated on that later return.

74. B — Form 940 is normally due January 31, but if the employer deposited the full FUTA tax liability on time throughout the year, the filing deadline is automatically extended ten additional days, to February 10. This accommodation rewards timely depositors with extra filing time; it does not align with partnership, S corporation, or individual income tax deadlines.

75. C — Section 3509 provides reduced rates for computing an employer's liability for federal income tax withholding and the employee share of FICA when workers are reclassified from independent contractor to employee status, absent intentional disregard. This softens, but does not eliminate, liability, and it addresses employer-level assessment rates rather than imposing personal trust fund recovery penalties on individual officers.

76. D — For a leased vehicle, once the standard mileage rate is chosen for the first year it is available for business use, it must be used for the entire remaining lease term, including renewal periods, if the standard rate is used at all. This differs from owned vehicles, where switching to actual expenses later, subject to certain limits, remains possible.

77. C — The simplified method caps the deductible home office area at 300 square feet regardless of the space's actual size, producing a maximum deduction of $1,500 at the $5 per square foot rate. Unlike the regular actual-expense method, which allows carryover of disallowed amounts due to income limits, the simplified method permits no such carryforward for space exceeding the 300-square-foot ceiling.

78. B — The Code creates a statutory nonemployee category for qualifying direct sellers and licensed real estate agents whose pay is tied substantially to sales output, not hours worked, performing services under a written contract stating they will not be treated as employees. Statutory nonemployees are treated as self-employed for income and self-employment tax purposes, not as common law or statutory employees.

79. D — Under the de minimis deposit rule, an employer whose total quarterly employment tax liability is less than $2,500 may pay it in full with a timely filed Form 941, instead of making periodic deposits. This exception requires no advance IRS approval and stops applying once the $100,000 next-day deposit trigger is reached during the quarter.

80. A — A trust must file Form 1041 if it has any taxable income, gross income of $600 or more, or a nonresident alien beneficiary. Because this trust has $200 of taxable income, filing is required even though gross income falls short of $600. The $600 threshold is only one independent trigger among several, not the sole filing requirement.

81. D — Section 645 allows the trustee of a qualified revocable trust and the estate's executor to jointly elect to treat the trust as part of the decedent's estate for income tax purposes, permitting a single combined Form 1041. This simplifies fiduciary administration and lets the trust share the estate's favorable tax attributes. The election is made on Form 8855.

82. A — Under Section 663(c), when a trust has substantially separate and independent shares for different beneficiaries, each share is treated as a separate trust solely for calculating distributable net income. This prevents a distribution to one beneficiary from distorting the DNI, and resulting tax character, allocated to another beneficiary's unrelated economic share.

83. C — Section 677 taxes the grantor on trust income that is or may be applied, without an adverse party's consent, to pay premiums on life insurance policies covering the grantor's own life. This grantor trust rule attributes that income directly to the grantor for income tax purposes, regardless of who technically holds or benefits from the policy.

84. B — Selling advertising space in an exempt organization's periodical is generally an unrelated trade or business, since soliciting and publishing paid advertisements for commercial gain is not substantially related to furthering the organization's exempt purpose. Net advertising income, computed under special circulation-income allocation rules, is includible in unrelated business taxable income each year.

85. A — Under Section 6033(j), an organization that fails to file its required annual return or notice for three consecutive years automatically loses its tax-exempt status, effective as of the filing due date of the third year. It must then reapply for recognition of exemption and may owe income tax for the intervening period.

86. D — Under the controlled group rules of Section 414(b) and (c), commonly owned businesses, here both wholly owned by the same individual, are treated as a single employer for qualified plan coverage and nondiscrimination testing. This prevents an owner from segregating favored employees into one entity's plan to avoid required testing.

87. C — The ADP test compares the average elective deferral percentages of highly compensated and non-highly compensated employees under Section 401(k). If the highly compensated group's average exceeds the allowable statutory spread over the non-highly compensated average, the plan fails, requiring corrective distributions, recharacterization, or additional qualified nonelective contributions to satisfy the test.

88. B — Section 175 allows farmers to currently deduct soil and water conservation expenditures consistent with an approved conservation plan, but the deduction is capped at 25% of gross income from farming for the year. Here, 25% of $60,000 is $15,000, so the excess $3,000 must be carried forward and deducted in later years.

89. D — Under Section 461(l), a noncorporate taxpayer's excess business loss above the annually adjusted threshold amount is disallowed for the current year but is not permanently lost. Instead, the disallowed excess is added to the taxpayer's net operating loss and carried forward, remaining deductible in future years subject to the usual NOL limitation rules.

90. B — An activity in which a taxpayer participates more than 100 hours but not enough to independently satisfy a material participation test is a significant participation activity. If the taxpayer's combined participation across all such activities exceeds 500 hours for the year, the taxpayer is treated as materially participating in each one.

91. A — The at-risk amount under Section 465 generally equals cash contributed, plus the adjusted basis of contributed property, plus amounts borrowed for use in the activity for which the taxpayer is personally liable or has pledged outside property as security. Here that totals $10,000 plus $8,000 plus $5,000, equaling $23,000 at risk.

92. C — Ordinary nonrecourse financing is normally excluded from a taxpayer's at-risk amount, but Section 465(b)(6) creates a special exception for qualified nonrecourse financing secured by real property and borrowed from a qualified unrelated lender on commercially reasonable terms. Such financing is treated as an amount at risk, unlike nonrecourse debt used in other activities.

93. A — Under the passive activity regulations, a taxpayer may group operations that constitute an appropriate economic unit for measuring gain or loss, based on facts and circumstances such as similarities in business type, common ownership and control, geographic location, and interdependence between the operations, rather than on an arbitrary or wholly unrelated factor.

94. C — Rents, royalties, interest, and annuities that would normally be excluded from unrelated business taxable income lose that exclusion under Section 512(b)(13) when received from a controlled subsidiary in which the exempt parent owns more than 50%. The payment is includible in UBTI to the extent it reduced the subsidiary's own taxable or net unrelated income.

95. B — A non-5%-owner participant who continues working beyond the applicable RMD age may, if the plan allows the still-working exception, delay the required beginning date until April 1 of the calendar year following the year of actual retirement. This exception is unavailable to 5% owners, who must begin distributions regardless of continued employment status.

96. D — Section 4942 requires a private non-operating foundation to make qualifying charitable distributions each year equal to at least 5% of the average fair market value of its noncharitable-use assets, reduced by certain deductions such as acquisition indebtedness. A foundation that fails to distribute this minimum amount faces a 30% excise tax on the undistributed portion.

97. C — Section 77 permits a farmer to elect to include Commodity Credit Corporation loan proceeds in gross income for the year received, rather than treating the loan as a nontaxable liability until the pledged commodity is later sold or forfeited. Once made, the election applies to all future CCC loans unless IRS consent changes it.

98. A — A central organization may obtain a group exemption ruling covering subordinate chapters or affiliates that are organized similarly, share the same general purposes, and remain subject to its general supervision or control. This lets related local units be treated as tax-exempt under the parent's ruling without each one separately applying for its own determination letter.

99. D — Plans generally classified as large plans, most commonly those with 100 or more participants with account balances at the start of the plan year, must attach an audit report prepared by an independent qualified public accountant to their Form 5500 filing. Small plans falling below that participant threshold are typically exempt from this audit requirement.

100. B — For trusts and estates, the 3.8% net investment income tax under Section 1411 applies to the lesser of undistributed net investment income or the excess of adjusted gross income over the dollar threshold at which the trust reaches the top income tax bracket, a much lower amount than the threshold that applies to individuals.