PRACTICE EXAM 21: 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. Meridian Partners, a newly formed partnership, pays $18,000 in commissions to a broker for selling partnership interests to prospective limited partners, plus additional printing costs for the offering materials used solely to market and sell those interests. How must Meridian treat these syndication costs for tax purposes?

A. The costs must be capitalized and are never deductible or amortizable by the partnership.
B. The costs may be amortized ratably over a 180-month period beginning with business start.
C. The costs are immediately deductible in full as an ordinary trade or business expense.
D. The costs are added to each partner's outside basis and recovered upon a future sale.

2. Priya is a member of Falcon Consulting, LLC, taxed as a partnership. She holds personal liability for LLC debts under the operating agreement, has authority to bind the LLC in contracts, and works full-time managing daily operations. For self-employment tax purposes, how is Priya's distributive share of ordinary income most likely treated?

A. Excluded from net earnings from self-employment because LLC members are always limited partners.
B. Excluded because state law liability protection automatically treats all LLC members as investors.

C. Included only if the LLC affirmatively elects corporate treatment on Form 8832 this year.

D. Included in net earnings from self-employment because her role fails the limited partner test.

3. At the beginning of the year, Partner Elias has an outside basis of $10,000 in his partnership interest. During the year, the partnership allocates him $6,000 of ordinary income and makes a $14,000 nonliquidating cash distribution to him. In what order must these items be applied to determine Elias's basis and any gain recognized?

A. Basis is decreased by the distribution first, then increased by income, limiting gain recognized.

B. Basis is increased by income first, then decreased by the distribution, before gain is tested.

C. Basis adjustments occur simultaneously, and the partnership chooses whichever order minimizes recognized gain.

D. The distribution is applied first against zero basis, triggering immediate gain on the full amount.

4. Timberline Partners has no Section 754 election in effect. In a liquidating distribution, Partner Osgood receives cash in excess of her outside basis, causing the partnership to recognize a substantial basis reduction of $310,000 in its remaining property, as measured under Section 734(d). What is the required tax treatment?

A. No basis adjustment is permitted anywhere because the partnership lacks a Section 754 election.

B. The partnership may adjust basis only if all remaining partners unanimously consent in writing.

C. The partnership must make a mandatory downward basis adjustment despite lacking a Section 754 election.

D. The adjustment is optional and deferred until a future Section 754 election is finally made.

5. A partnership agreement specially allocates nonrecourse deductions disproportionately to Partner Voss, who bears none of the economic risk of loss for the underlying nonrecourse debt. For this allocation to be respected under the Section 704(b) safe harbor for nonrecourse deductions, what must the partnership agreement include?

A. A minimum gain chargeback provision requiring income allocation if partnership minimum gain later decreases.

B. A deficit restoration obligation requiring Voss to restore any negative capital account balance in cash.

C. Written personal guarantees from Voss covering the full outstanding balance of the nonrecourse debt.
D. Unanimous partner consent obtained annually before any nonrecourse deduction may ever be allocated at all.

6. A father forms a family limited partnership and transfers a 30% capital interest to his adult daughter as a gift. However, the partnership agreement gives the father the unilateral right to revoke the transfer at any time and to redirect all distributions attributable to that interest back to himself. How is the daughter's interest treated for federal tax purposes?

A. The daughter is fully recognized as a bona fide partner because she received a completed gift.
B. The daughter is not recognized as the real owner because the father retained dominion and control.
C. The daughter is recognized as owner only for capital purposes but not for income allocations.
D. The daughter is treated as an employee of the partnership rather than as a partner at all.

7. Limited partner Foster invests in a partnership that leases heavy construction equipment to contractors. The equipment purchase is financed by a nonrecourse loan from a bank unrelated to any partner, secured solely by the equipment itself, with no partner personally liable for repayment. Does this nonrecourse financing increase Foster's amount at risk under Section 465?

A. Yes, because equipment financed entirely by nonrecourse debt is always treated as fully at risk under the general at-risk computation rules.
B. Yes, but only if Foster also holds a security interest in the underlying equipment as additional collateral for the loan.
C. No, because equipment leasing partnerships are entirely exempt from the at-risk limitation rules under Section 465(c).
D. No, because the qualified nonrecourse financing exception under Section 465(b)(6) applies only to real property, not equipment leasing activities.

8. Ridgecrest Partners has 60 partners for the tax year, all of whom are individuals, C corporations, S corporations, or eligible estates, with none being another partnership, trust, or disregarded entity. The partnership wants to avoid the centralized partnership audit regime entirely for the year. What must it do?

A. Nothing; partnerships with fewer than 100 partners are automatically excluded without any election required.
B. File Form 8832 electing corporate tax classification, which automatically removes it from the audit regime.
C. Make a valid annual election out under Section 6221(b) on a timely filed partnership return.
D. Obtain written consent from the IRS National Office at least 90 days before the filing deadline.

9. Beacon Partners terminates under Section 708(b)(1) on September 30 when it ceases all business operations and winds up completely. Partner Kowalski, who held her interest the entire year, wants to know how this termination affects her partnership tax year for reporting purposes on her individual return.

A. Her partnership tax year continues uninterrupted through December 31, unaffected by the entity's termination.
B. Only partners who affirmatively request it may close their tax year early upon termination.
C. The partnership's tax year closes for all partners simultaneously as of the termination date.
D. Her tax year closes only if she personally disposed of her entire interest that day.

10. A married couple, residing in a non-community-property state, jointly owns and operates an unincorporated landscaping business. Both spouses materially participate in the business, and they wish to avoid filing a partnership return while still splitting income and deductions between them. What election allows this treatment?

A. A qualified joint venture election under Section 761(f), reporting the business on two Schedules C.
B. An S corporation election filed jointly by both spouses on Form 2553 before year-end.
C. A community property election available nationwide regardless of the couple's state of residence.
D. A disregarded entity election under the check-the-box regulations for the jointly owned business.

11. Partner Delgado's amount at risk in a partnership activity is $8,000 at the start of the year. Her distributive share of the activity's loss for the year is $15,000. She has no other passive or nonpassive income to absorb the excess. What happens to the $7,000 portion of the loss that exceeds her amount at risk?

A. It is permanently disallowed and can never be deducted in any future tax year.

B. It automatically converts into a nondeductible reduction to Delgado's outside basis in the partnership.

C. It must be carried back two years and applied against the activity's income in those years.

D. It is suspended and carried forward, deductible in a later year when her amount at risk increases.

12. A partnership pays $9,600 in health insurance premiums during the year on behalf of Partner Nkemdirim, covering her and her family under a plan established by the partnership. The payment is treated as a guaranteed payment for services under the partnership agreement. How must Nkemdirim treat this amount on her individual return?

A. It is entirely excluded from her gross income as a tax-free fringe benefit.

B. It is included in gross income as a guaranteed payment, subject to self-employment tax.

C. It is treated as a nontaxable capital contribution returned to her outside basis.

D. It is reported as passive investment income, exempt from self-employment tax entirely.

13. Partner Castillo has an outside basis of $50,000 in her partnership interest. In a nonliquidating distribution, the partnership distributes property to her with an adjusted basis to the partnership of $18,000. Castillo has ample remaining outside basis after the distribution. What basis does she take in the distributed property?

A. $50,000, because her outside basis is more than sufficient to support a full step-up.

B. $34,000, representing the average of her outside basis and the property's inside basis.

C. $18,000, the same basis the property had in the hands of the partnership.

D. $0, because nonliquidating distributions always require a fresh cost basis be assigned instead.

14. Following a completed BBA audit, Cascade Partners receives a notice of final partnership adjustment (FPA). Rather than paying the imputed underpayment at the entity level, the partnership timely elects under Section 6226 to push the adjustment out to its reviewed-year partners. What is the primary consequence of this election?

A. Each reviewed-year partner reports her share of the adjustment on her own return, with interest.

B. The partnership representative alone becomes personally liable for the entire imputed underpayment amount.

C. The adjustment is permanently waived, and no tax is ever collected from anyone at all.

D. The IRS must recompute the adjustment using the partnership's current-year partners instead of reviewed-year ones.

15. Sole proprietor Owen operates a small cattle farm as his principal trade. His gross farm income for the year is $7,200, and his actual net farm profit is only $1,100. Owen wants to maximize his Social Security coverage credits for the year using the farm optional method for computing net earnings from self-employment. What figure may he report instead of his actual net profit?

A. He must report his actual net profit of $1,100, since no optional method exists for farmers.

B. He may report two-thirds of his gross farm income, up to the annually indexed dollar cap.

C. He may report his gross farm income in full, with no cap or percentage limitation applied.

D. He may report a flat $6,040 regardless of his actual gross income for the year.

16. In complete liquidation of her partnership interest, Partner Iyer receives $5,000 cash and is relieved of her $9,000 share of partnership recourse liabilities as the remaining partners assume that debt. Iyer's outside basis immediately before the distribution was $11,000. How is the liability relief treated in determining her gain or loss?

A. The liability relief is entirely ignored because only actual cash distributions affect outside basis.

B. The liability relief permanently increases her outside basis rather than reducing it at all.

C. The liability relief converts automatically into additional taxable compensation income reportable on Form W-2.

D. The liability relief is treated as a deemed cash distribution under Section 752(b), reducing basis.

17. Partner Whitfield is a bona fide general partner in Summit Advisory Partners. To simplify payroll, the partnership also issues her a Form W-2 for a portion of her compensation and withholds FICA taxes on those wages, treating her as a dual-status partner-employee. Is this treatment permitted under longstanding IRS guidance?

A. Yes, provided the partnership documents a formal separate employment agreement covering those specific duties.

B. No, a bona fide partner cannot also be treated as an employee of the same partnership.

C. Yes, but only for services entirely unrelated to the partnership's regular trade or business.

D. No, but only because Whitfield owns less than a 5% profits interest in the partnership.

18. Vantage Partners' partnership agreement is silent on removing or replacing the partnership representative once designated on a filed return. During an ongoing BBA examination, a majority of the partners want to replace the current partnership representative with someone they trust more, but the partnership representative refuses to resign voluntarily. What generally governs this situation?

A. State partnership law controls resignation and replacement of a partnership representative, overriding any federal procedural requirement.

B. The partnership representative designation is permanent for the life of the partnership and can never be changed once made.

C. A simple majority vote of the partners automatically and immediately revokes the representative's authority without any IRS filing.

D. Until a new representative is validly designated under the applicable regulations, the IRS continues dealing exclusively with the current one.

19. Underwood, Voss, Patel, and Reyes form Cascade Corp. Underwood, Voss, and Patel each transfer land and equipment in exchange for stock. Reyes, an attorney, transfers no property and receives stock solely in exchange for legal services performed in organizing the corporation. Immediately after the exchange, Underwood, Voss, and Patel together hold 82% of Cascade Corp's stock. For purposes of the Section 351 control test, how is Reyes treated?

A. Reyes counts toward the transferor group because all four received stock in the same integrated transaction

B. Reyes's services-for-stock exchange is tax-free because he is part of a qualifying group of transferors

C. Reyes is excluded from the transferor group entirely, and only Underwood, Voss, and Patel's stock is counted in testing control

D. Reyes must contribute at least 10% of the value of the other transferors' property to be excluded from the group

20. Falcon Corp, a C corporation, has current and accumulated E&P of $40,000 combined. It distributes $70,000 cash to its sole shareholder, Nadia, whose stock basis is $25,000. How should Nadia treat the distribution?

A. $40,000 dividend income, $25,000 tax-free return of basis, and $5,000 capital gain
B. $70,000 dividend income because the entire distribution is taxed at ordinary rates
C. $40,000 dividend income and $30,000 tax-free return of capital with no gain recognized
D. $25,000 tax-free return of basis first, then $40,000 dividend, then $5,000 capital gain

21. Bristol Corp, a C corporation, distributes non-liquidating land with a fair market value of $90,000 and an adjusted basis of $55,000 to its sole shareholder as a dividend. The land is not subject to any liability. What is the tax result to Bristol Corp?

A. Bristol Corp recognizes $35,000 of gain, as if it had sold the land to the shareholder for fair market value
B. Bristol Corp recognizes no gain because losses and gains on distributions of property are never recognized by a corporation
C. Bristol Corp recognizes $35,000 of loss because the distribution reduces the corporation's earnings and profits
D. Bristol Corp defers all gain recognition until the shareholder later sells the land to a third party

22. An S corporation has a beginning-of-year AAA balance of $10,000. During the year, it earns $30,000 of ordinary income and distributes $35,000 cash to its shareholders. In what order are the AAA increase for income and the AAA decrease for the distribution applied?

A. The distribution is applied first, reducing AAA to zero, and the income increase is applied afterward
B. The income increase is applied first, bringing AAA to $40,000, and the distribution is then applied, reducing AAA to $5,000
C. Income and distributions are applied simultaneously on a pro rata basis, netting to a $5,000 increase in AAA
D. AAA is not adjusted for ordinary income; only distributions and separately stated loss items affect the AAA balance

23. An S corporation has issued a written unconditional promise to pay a sum certain on demand or on a specified date, bearing interest not contingent on profits, not convertible into stock, and held by an individual eligible S corporation shareholder. How does this instrument affect the corporation's S election under the one-class-of-stock rule?

A. The instrument automatically creates a second class of stock, terminating the S election immediately
B. The instrument is treated as stock only if it is held by more than 10% of the shareholders
C. The instrument qualifies for the straight debt safe harbor and is not treated as a second class of stock
D. The instrument is disregarded entirely and has no effect on basis or the corporation's tax attributes

24. Priya is the original owner of stock that qualifies as Section 1244 small business stock. She sustains a $120,000 loss on the stock in the current year and files a joint return with her spouse. What is the maximum amount of that loss she may deduct as an ordinary loss under Section 1244 for the year, with any remainder treated as capital loss?

A. $120,000, since Section 1244 allows the entire loss to be treated as ordinary with no dollar limitation
B. $50,000, the Section 1244 ordinary loss limit for a single individual regardless of filing status
C. $3,000, the standard annual limit on capital losses deductible against ordinary income
D. $100,000, the Section 1244 ordinary loss limit for taxpayers filing a joint return, with the remaining $20,000 treated as capital loss

25. Marcus, the sole shareholder of an S corporation, previously made a $20,000 loan to the corporation on a formal note. Losses passed through in prior years reduced his debt basis to $12,000. In the current year, the corporation repays the entire $20,000 loan in cash, and Marcus's debt basis has not been restored by any intervening income. What is the tax result to Marcus?

A. No gain is recognized because repayment of a bona fide loan is always a tax-free return of principal
B. Marcus recognizes $8,000 of gain, the excess of the amount repaid over his reduced debt basis
C. Marcus recognizes $20,000 of ordinary income because the entire repayment is treated as a corporate distribution
D. Marcus's stock basis is reduced by $8,000 to account for the difference, and no gain is recognized

26. XYZ Corp is owned by four individuals holding all outstanding stock (more than 50% by value), and 65% of XYZ Corp's adjusted ordinary gross income for the year consists of dividends and interest from its investment portfolio; the remainder comes from an active manufacturing business. XYZ Corp is classified as a personal holding company (PHC) for the year. At what rate is XYZ Corp's undistributed PHC income taxed?

A. Undistributed PHC income is taxed at 20%, the top rate applicable to net capital gain under current law

B. Undistributed PHC income is taxed at the regular flat 21% corporate income tax rate applied a second time

C. Undistributed PHC income is taxed at 15%, matching the qualified dividend rate for individual shareholders

D. Undistributed PHC income is exempt from any additional tax once the corporation is classified as a PHC

27. Corporation X, a single existing corporation, exchanges outstanding bonds held by its bondholders for newly issued shares of common stock, with no other corporation involved in the transaction. How is this transaction classified for federal tax reorganization purposes?

A. A Type A statutory merger, since it involves an exchange of one type of security for another

B. A Type C reorganization, since it involves an acquisition of substantially all of the corporation's assets

C. A Type E reorganization, a recapitalization involving a readjustment of a single corporation's capital structure

D. A taxable exchange, since reorganization treatment requires the involvement of at least two separate corporations

28. Acquiring Corp acquires substantially all of Target Corp's assets solely in exchange for Acquiring voting stock. As part of the transaction, Acquiring also assumes Target's outstanding liabilities. Target then distributes the Acquiring stock to its shareholders and liquidates. Does Acquiring's assumption of Target's liabilities disqualify this transaction from Type C reorganization treatment under Section 368(a)(1)(C)?

A. Yes, any assumption of liabilities by the acquiring corporation automatically disqualifies a Type C reorganization regardless of amount.

B. Yes, because the solely-for-voting-stock requirement is violated the moment any consideration other than stock changes hands.

C. No, but only if Target's shareholders unanimously consent in writing to the assumption of liabilities by Acquiring Corp.

D. No, the assumption of liabilities is disregarded in applying the solely-for-voting-stock requirement of a Type C reorganization.

29. Acquiring Corp transfers a portion of its assets to Newco, a newly formed corporation, in exchange for substantially all of Newco's stock. Acquiring Corp then distributes the Newco stock to its own shareholders in complete liquidation, and the transaction does not satisfy the active trade or business and other requirements of Section 355. How is this transaction most likely classified?

A. A tax-free Section 355 spinoff, because a new subsidiary was formed and its stock distributed to shareholders

B. A nondivisive Type D reorganization, because the transferor liquidates and does not satisfy the Section 355 divisive requirements

C. A Type A merger, because Acquiring Corp's business operations are combined with Newco's operations

D. A wholly taxable asset sale, because transfers to newly formed corporations can never qualify under Section 368

30. A C corporation that is not a personal service corporation has accumulated earnings and profits of $150,000 at the beginning of the year and no documented reasonable business needs for retaining additional earnings. Before applying any accumulated earnings tax, what is the minimum accumulated earnings credit generally available to shelter accumulated earnings from the tax, regardless of documented business need?

A. $50,000, matched to the accumulated earnings and profits threshold used for the corporate alternative minimum tax

B. $0, because the credit is eliminated once accumulated earnings and profits exceed $100,000

C. $150,000, equal to the corporation's entire accumulated earnings and profits balance at the start of the year

D. $250,000 minus the corporation's accumulated earnings and profits at the beginning of the year (as low as $0), or $150,000 for personal service corporations

31. Five unrelated individuals own all the stock of both Acorn Corp and Birch Corp. Together, the five individuals own at least 80% of each corporation's stock, and when each individual's identical (lowest common) ownership percentage in both corporations is totaled, the sum exceeds 50%. Under Section 1563, how are Acorn Corp and Birch Corp classified?

A. As a brother-sister controlled group, because both the 80% common ownership test and the 50% identical ownership test are satisfied.

B. As a parent-subsidiary controlled group, because one corporation directly owns more than 50% of the other's stock.

C. As unrelated corporations, because five individual owners exceeds the maximum number permitted under the controlled group rules.

D. As a combined group only, which requires at least one corporation to also be a component of a parent-subsidiary group.

32. A newly formed domestic LLC with two members wants to be taxed as an S corporation beginning with its first tax year. Under IRS procedures, must the LLC file Form 8832 to elect corporate classification before it can file Form 2553 to elect S status?

A. Yes, Form 8832 electing corporate classification must be filed and approved before Form 2553 can be filed

B. Yes, but only if the LLC has more than two members at the time of the election

C. No, a timely and properly filed Form 2553 alone is treated as a deemed election of corporate classification and an S election

D. No, LLCs are permanently barred from making an S corporation election under the check-the-box regulations

33. A C corporation converts to S status. At the conversion date, its net unrealized built-in gain (NUBIG) was $80,000. Over the following three years within the recognition period, the corporation recognizes $95,000 of cumulative built-in gains on asset dispositions. What is the maximum cumulative amount subject to the Section 1374 built-in gains tax over the recognition period?

A. $95,000, the full cumulative amount of gain actually recognized during the recognition period

B. $0, because built-in gains tax applies only in the single year immediately following conversion

C. $80,000, the amount of net unrealized built-in gain existing at the conversion date, as a ceiling on cumulative recognition

D. $15,000, the excess of recognized gain over the net unrealized built-in gain amount

34. Parent Corp owns 85% of Subsidiary Corp's only class of stock; the remaining 15% is owned by Wells, an unrelated minority shareholder. Subsidiary Corp completely liquidates, distributing property pro rata to both shareholders in cancellation of their stock. Parent Corp qualifies for nonrecognition under Section 332. How does Wells, the minority shareholder, treat the liquidating distribution he receives?

A. Wells also qualifies for full nonrecognition under Section 332 because Subsidiary Corp as a whole meets the 80% ownership test

B. Wells recognizes gain or loss under Section 331, treating the distribution as full payment in exchange for his stock

C. Wells must defer all gain until Parent Corp itself is liquidated or sells the distributed property

D. Wells automatically succeeds to Subsidiary Corp's basis and holding period in the distributed property under Section 334(b)

35. For purposes of determining component members of a controlled group and applying the group's single set of graduated tax brackets and accumulated earnings credit, on what date during the tax year is controlled group membership generally tested?

A. December 31 of the tax year (or the last day of the group's tax year), the standard testing date for component membership

B. January 1, the first day of the corporation's tax year, regardless of ownership changes made afterward

C. The date the corporation was originally incorporated, which remains fixed for all future controlled group determinations

D. The date the corporate tax return is filed, reflecting ownership as of that filing date

36. Larkin Hardware, a sole proprietorship, has total liabilities of $340,000 and total assets with a fair market value of $260,000 immediately before a lender cancels $50,000 of business debt. Larkin's insolvency exceeds the amount of debt canceled. How much of the $50,000 canceled debt must Larkin include in gross income?

A. The full $50,000, because cancellation of business debt is always fully includible regardless of the taxpayer's solvency.

B. $30,000, the amount by which the cancellation exceeds Larkin's remaining tax attributes after required reductions.

C. Half of the canceled amount, since only 50% of business debt cancellation is ever excludable from income.
D. None of the $50,000, because the exclusion for debt canceled while insolvent applies up to the full insolvency amount.

37. A tornado destroys a warehouse business Redstone Freight uses in its trade or business. Redstone's adjusted basis in the warehouse was $180,000, and it receives $260,000 in insurance proceeds. Within the replacement period, Redstone purchases a similar warehouse for $250,000. Under IRC Section 1033, how much gain must Redstone recognize?

A. $80,000, the entire realized gain on the involuntary conversion
B. $10,000, the amount of proceeds not reinvested in replacement property
C. $70,000, the difference between the basis and the replacement cost
D. $0, because involuntary conversions of business property are always fully tax-free

38. Vantage Securities is a dealer in securities that has properly made a mark-to-market election under IRC Section 475. At year-end, Vantage holds securities in its dealer inventory with a fair market value exceeding its basis by $90,000, even though none of the securities were sold. How must Vantage treat this $90,000 for tax purposes?

A. As unrecognized gain deferred until the securities are actually sold to a customer
B. As long-term capital gain, reported only if the securities were held over one year
C. As tax-exempt income because unrealized appreciation is not includible until realization occurs
D. As ordinary income recognized in the current year as if the securities were sold at fair market value

39. Dana operates a sole proprietor cattle farm and reports unusually high taxable income in 2025 after several average years. To reduce the effect of the spike, Dana wants to spread a portion of the farm income back over the three prior tax years. What form does Dana use to make this election?

A. Schedule J (Income Averaging for Farmers and Fishermen)
B. Form 3115 (Application for Change in Accounting Method)
C. Schedule F (Profit or Loss From Farming)
D. Form 4835 (Farm Rental Income and Expenses)

40. Kade lends $150,000 interest-free to his wholly owned corporation, KadeCo, which uses the funds in its business. The loan is outstanding all year and exceeds the $10,000 de minimis exception. Under the below-market loan rules of IRC Section 7872, how is this arrangement generally treated for tax purposes?

A. No interest is imputed because loans between an owner and a corporation are exempt from Section 7872

B. Kade must recognize a taxable gift equal to the full principal amount of the loan

C. Kade is treated as receiving imputed interest income, and KadeCo is treated as paying a corresponding distribution

D. KadeCo recognizes cancellation of debt income equal to the foregone interest for the year

41. For the 2025 tax year, a single taxpayer's sole proprietorship generates $650,000 of allowable business deductions against $150,000 of business gross income and gain, producing a large net business loss. Under IRC Section 461(l), what happens to the portion of this loss that exceeds the applicable excess business loss threshold?

A. It is disallowed for the current year and carried forward as part of the taxpayer's net operating loss

B. It is permanently disallowed and may never be deducted in any future tax year

C. It is fully deductible currently because sole proprietorship losses are exempt from the limitation

D. It reduces the taxpayer's self-employment tax liability but not the income tax liability

42. Willow Design Studio is a member of a third-party barter exchange that facilitates trades of goods and services among its members using barter credit units. During the year, Willow receives 5,000 barter credits for design services rendered to other members. How must Willow treat these barter credits for federal tax purposes?

A. Ignore the credits until they are actually redeemed for cash or property

B. Report the credits only if the exchange fails to issue an information return

C. Include the fair market value of the credits in gross income for the year received

D. Treat the credits as a nontaxable exchange of services under the barter safe harbor

43. Turlock Manufacturing sells a machine used in its business for $95,000 cash. The machine's original cost was $120,000, and Turlock had claimed $70,000 of depreciation, leaving an adjusted basis of $50,000. Under IRC Section 1245, how much of the $45,000 gain must Turlock recharacterize as ordinary income?

A. $0, because Section 1245 recapture applies only to real property, not equipment
B. $25,000, limited to the excess of the sale price over the original cost
C. $50,000, equal to the machine's full adjusted basis at the time of sale
D. $45,000, the entire gain, because it does not exceed total depreciation claimed

44. In 2022 and 2023, Bellamy Corp reported net Section 1231 losses of $20,000 and $15,000, respectively, both deducted as ordinary losses and never recaptured. In 2026, Bellamy recognizes a net Section 1231 gain of $50,000 from selling business equipment. Under the Section 1231 five-year lookback rule, how must Bellamy treat the 2026 gain?

A. All $50,000 is treated as long-term capital gain because the prior losses are unrelated
B. $35,000 is treated as ordinary income, and the remaining $15,000 as long-term capital gain
C. $20,000 is treated as ordinary income, and the remaining $30,000 as long-term capital gain
D. The entire $50,000 gain is treated as ordinary income under the recapture rule

45. An accrual-method business, Iron Gate Logistics, is legally obligated to pay a $30,000 workers' compensation claim to an injured employee under state law. The claim was finalized in December 2025, but Iron Gate does not actually pay the injured employee until February 2026. Under the economic performance rules of IRC Section 461(h), when may Iron Gate deduct the $30,000?

A. In 2026, the year the claim is actually paid to the injured employee
B. In 2025, the year the liability became fixed and legally enforceable
C. In 2025, using the recurring item exception regardless of when payment occurs
D. Ratably over both 2025 and 2026 based on when each event occurred

46. Bramwell Corp, a calendar-year C corporation, wants to avoid an underpayment penalty on its 2026 quarterly estimated tax payments. Bramwell's 2025 tax liability was $80,000, and it does not qualify as a large corporation under the estimated tax rules. What is the standard safe harbor Bramwell may use to set its 2026 installment payments?

A. Pay at least 90% of the prior year's tax liability in each installment
B. Pay any amount, since corporations are never subject to underpayment penalties
C. Pay installments totaling 100% of the prior year's tax shown on the 2025 return
D. Pay installments totaling 110% of the current year's projected tax liability

47. Nolan sells a piece of commercial equipment to Cedar Corp, a corporation Nolan owns 100%, at a $40,000 gain. Cedar Corp will use the equipment in its business and depreciate it. Absent the related-party rule of IRC Section 1239, the gain would otherwise be capital gain. How must Nolan report the $40,000 gain?

A. As long-term capital gain, since the sale price reflects fair market value
B. As ordinary income, because the buyer is a related party that will depreciate the asset
C. As tax-exempt income, because transfers to a wholly owned corporation are disregarded
D. As a nondeductible loss to Cedar Corp equal to the gain Nolan recognized

48. Harborview Retail replaces the entire roof structure of its warehouse after storm damage, restoring the building to like-new condition and materially increasing its useful life. The cost is substantial relative to the building's overall value. Under the tangible property regulations, how must Harborview treat this roof replacement cost?

A. Deduct the cost currently as ordinary repair and maintenance expense
B. Deduct the cost under the routine maintenance safe harbor automatically
C. Elect the de minimis safe harbor to expense the entire cost
D. Capitalize the cost as a restoration that improves the unit of property

49. Fairview Properties, a cash-method landlord, receives $2,000 from a new tenant, designated in the lease as a refundable security deposit to be returned at the end of the tenancy if the unit is undamaged. Fairview also receives $1,800 from the same tenant as the first and last month's rent paid in advance. How must Fairview treat these amounts upon receipt?

A. Include the $1,800 advance rent in income; exclude the refundable security deposit
B. Include both the deposit and the advance rent in gross income immediately
C. Exclude both amounts until the lease terminates and a final accounting is made
D. Include the $2,000 deposit in income; exclude the $1,800 advance rent

50. Quill Enterprises purchases the assets of a competing business, including $300,000 allocated to goodwill under the purchase price allocation rules. Under IRC Section 197, over what period must Quill amortize this goodwill for federal income tax purposes?

A. Over the remaining useful life of the underlying business, as determined by an appraisal
B. Over 5 years, using straight-line amortization regardless of the asset's actual useful life
C. Over 10 years, matching the standard recovery period for most tangible business assets
D. Over 15 years, using straight-line amortization regardless of the asset's actual useful life

51. Titan Fabrication Inc. placed $600,000 of new 5-year MACRS qualified property in service on August 1, 2025, under a binding contract entered into that same month. Under current law applicable to qualified property acquired and placed in service after January 19, 2025, what is the applicable first-year bonus depreciation percentage for this property?

A. 40%
B. 60%
C. 100%
D. 80%

52. In 2023, Delia expensed $40,000 of computer equipment under Section 179, when the equipment was used 90% for her consulting business. In 2025, before the equipment's 5-year MACRS recovery period ended, her business-use percentage fell to 45%. What must Delia do as a result of this decline in business use?

A. Continue depreciating the equipment normally, since no adjustment is required at all
B. Recapture the excess of the Section 179 deduction over allowable regular depreciation as income
C. Amend her 2023 return to remove the Section 179 election entirely from that year
D. Treat the decline in business use as a taxable like-kind exchange requiring gain deferral

53. A newly formed accounting firm purchased desks, filing cabinets, and other office furniture and fixtures for its new office. Under MACRS, what is the correct recovery period classification for this office furniture and fixtures under the General Depreciation System?

A. 5-year property
B. 39-year property
C. 15-year property
D. 7-year property

54. Marcus, a single taxpayer whose taxable income is well above the applicable QBI threshold, owns a non-SSTB manufacturing business with $80,000 of W-2 wages paid and $500,000 of unadjusted basis immediately after acquisition (UBIA) in qualified property. What is the wage and capital limitation formula used to cap his QBI deduction for this business?

A. The greater of 50% of W-2 wages, or 25% of W-2 wages plus 2.5% of UBIA
B. The lesser of 50% of W-2 wages, or 25% of W-2 wages plus 2.5% of UBIA
C. A flat 20% of the business's W-2 wages is used, without any UBIA component at all
D. The greater of 50% of UBIA, or 25% of wages plus 2.5% of net income

55. A corporation is applying several components of the general business credit for the current tax year, including a research credit generated this year and a carryforward from a prior year. In what order does Section 38 require these credit amounts to be used?

A. Current-year credits are used first, followed by carryforwards from the earliest year
B. Carryforwards from the earliest year are used first, followed by current-year credits
C. The taxpayer may choose any order that minimizes total tax liability for the year
D. All components are used simultaneously on a pro-rata basis each and every year

56. Renata is the sole owner of a licensed architecture firm that designs commercial buildings. Her taxable income exceeds the fully phased-in QBI threshold. For purposes of the Section 199A qualified business income deduction, how is her architecture firm treated?

A. As a specified service trade or business, fully disqualified from any QBI deduction

B. As a specified service trade or business, but only partially disqualified based on revenue

C. As a non-SSTB, eligible for the QBI deduction subject to the wage and capital limitation

D. As a specified service trade or business only if she employs fewer than ten people

57. Before opening her bakery, Priya incurred $48,000 of qualifying start-up expenditures investigating the market and setting up operations, and the bakery began business in October 2025. Under Section 195, how must Priya treat these start-up costs on her 2025 return?

A. Deduct the entire $48,000 immediately in 2025, with absolutely no limitation applied

B. Capitalize the full $48,000 amount and recover it only upon sale of the business

C. Deduct $5,000 immediately since total costs are under $50,000, amortizing the $43,000 balance over 180 months

D. Deduct $5,000 immediately, then amortize the remaining $43,000 balance over just 60 months

58. Grant owns 100% of an S corporation that generates $300,000 of net income. As a shareholder-employee performing substantial services, Grant is paid $120,000 in reasonable W-2 compensation, which is deducted in arriving at the $300,000. How is Grant's W-2 compensation treated for purposes of computing his qualified business income?

A. It is included in QBI because it represents his share of business earnings

B. It is excluded from QBI, since shareholder-employee compensation is not qualified business income

C. It is included in QBI only if the taxpayer's income is below the threshold

D. It is included in QBI but excluded from the wage limitation calculation entirely

59. A manufacturer incurred costs testing a new production process to eliminate technical uncertainty about how to achieve a desired result. After the process was implemented and commercial production began, the company incurred additional costs fine-tuning the process for routine quality control and cosmetic style preferences. How are the post-commercial-production costs treated for the Section 41 research credit?

A. Excluded from qualified research expenses, since research after commercial production has begun does not qualify

B. Included in qualified research expenses at the same rate as the original process development costs

C. Included in qualified research expenses only if performed by a contractor rather than employees

D. Excluded from qualified research expenses only if the company elects the regular credit method

60. An employer hires an individual from a WOTC-targeted group on June 2. To properly claim the Work Opportunity Tax Credit for this new hire, by what date must the employer submit the completed pre-screening notice, Form 8850, to the designated state workforce agency?

A. Within 10 days after the employee's first day of work

B. Within 90 days after the end of the tax year

C. No later than the employee's start date itself

D. Within 28 days after the employee begins work

61. A limited partner holds an interest in a partnership that generates a general business credit from an activity in which the partner does not materially participate. The partner has no other passive income for the year. How may this general business credit generally be used?

A. It is limited to offsetting tax attributable to the partner's passive activity income

B. It may fully offset the partner's tax on wage and portfolio income without restriction

C. It must be carried back three years before being carried forward at all

D. It automatically converts into a nonrefundable QBI deduction add-on for the year

62. A business sold equipment at a gain during the year, and under Section 1231 the entire gain was characterized as long-term capital gain on the owner's return. How is this Section 1231 gain treated in computing the business's qualified business income?

A. It is included in QBI at the same character as ordinary business income

B. It is included in QBI, but only up to 50% of the gain amount

C. It is excluded from QBI, since capital gain items are not qualified items of income

D. It is included in QBI only if the equipment was Section 179 property

63. A calendar-year business placed several items of 7-year MACRS personal property in service during the fourth quarter, along with a nonresidential real property building placed in service in November. The personal property triggers the mid-quarter convention because more than 40% of total personal property basis was placed in service in the last quarter. Does the mid-quarter convention also apply to the building?

A. Yes, because both assets were placed in service in the fourth quarter

B. Yes, but only if the building's basis exceeds the personal property's basis

C. No, because real property is always depreciated under the half-year convention instead

D. No, because real property is never subject to mid-quarter and always uses mid-month convention

64. Mr. and Mrs. Chen are married and file separate returns for 2025. Mr. Chen operates a sole proprietorship and wants to claim Section 179 expensing on qualifying equipment. Absent any election by either spouse to allocate a different percentage, how is the Section 179 dollar limitation applied between them?

A. Each spouse may claim the full dollar limitation independently, with no reduction for filing separately

B. Each spouse is treated as one taxpayer, allocated 50% of the limitation absent a joint election otherwise

C. Only the spouse with the higher taxable income may claim any Section 179 deduction

D. The dollar limitation is eliminated entirely for taxpayers who file married filing separately

65. A business owns equipment with an original unadjusted basis of $200,000, placed in service nine years ago under a 5-year MACRS recovery period. The equipment is still used in the business today. For purposes of computing UBIA of qualified property in the QBI wage and capital limitation, is this equipment still counted?

A. No, because its 5-year MACRS recovery period expired years ago already

B. No, because UBIA only includes property placed in service in the current tax year

C. Yes, property remains in its depreciable period until the later of its recovery period or 10 years post-service

D. Yes, but only at its current adjusted (depreciated) basis rather than its original basis

66. Wendy worked for Employer X from January through May 2025 and for Employer Y from June through December 2025. Each employer correctly withheld Social Security tax on Wendy's wages up to the annual wage base without exceeding it individually. Combined, however, her total Social Security tax withheld for the year exceeded the statutory maximum. What may Wendy do?

A. She must ask each employer to refund the excess amount withheld before filing her return
B. She may claim the excess Social Security tax withheld as a credit on her Form 1040
C. She forfeits the excess amount because each employer withheld correctly within the wage base
D. She must file Form 941-X jointly with both employers to correct the withholding

67. A small retail business paid a part-time employee wages of $1,800 in the second calendar quarter of the year but paid no other employee more than $400 in any single quarter, and no employee worked in 20 different calendar weeks. Is the business subject to FUTA for the year?

A. No, because FUTA only applies once total annual wages paid exceed $7,000 per employee
B. No, because FUTA coverage requires at least one employee working 20 different weeks
C. No, because FUTA applies only to businesses with four or more employees at once
D. Yes, because paying $1,500 or more to any employee in a calendar quarter triggers coverage

68. A company's controller was authorized to sign checks, decided which creditors to pay during a cash shortage, and knowingly used withheld payroll taxes to pay trade suppliers instead of remitting them to the IRS. When the company later becomes insolvent and cannot pay the delinquent payroll taxes, what personal liability does the controller face?

A. The Trust Fund Recovery Penalty under Section 6672, equal to the unpaid withheld taxes, because she was a responsible person who acted willfully.
B. No personal liability at all, because payroll tax obligations belong solely to the corporate entity regardless of individual conduct.
C. Liability limited to 10% of the unpaid withheld taxes, capped under the reasonable cause exception to Section 6672.
D. Liability only if the IRS first exhausts all collection remedies against the company's remaining corporate assets and officers.

69. In evaluating whether a worker is a common law employee or an independent contractor, the IRS considers the relationship of the parties as one of three broad categories of evidence. Which fact, standing alone, is most indicative of an employment relationship rather than an independent contractor relationship?

A. The worker is paid a flat fee upon completion of a defined, discrete project
B. The worker furnishes all of his own tools, equipment, and work materials
C. The business may discharge the worker at any time without contractual liability
D. The worker performs similar services for several unrelated businesses simultaneously

70. An employer is a semiweekly depositor for federal employment taxes. If the employer pays wages on a Friday, by what date must the associated employment tax deposit generally be made?

A. The following Wednesday
B. The following Friday
C. The following Monday
D. The same banking day

71. A nonprofit organization recognized by the IRS as exempt under Section 501(c)(3) pays wages to several employees during the year. With respect to FUTA, how should this organization generally treat those wages?

A. Wages are fully subject to FUTA the same as a for-profit business
B. Wages paid by the 501(c)(3) organization are exempt from FUTA tax
C. Wages are subject to FUTA only if the organization has 10 or more employees
D. Wages are subject to FUTA only above the standard $7,000 wage base

72. A very small employer has been notified in writing by the IRS that its estimated annual employment tax liability qualifies it to file its employment tax return annually instead of quarterly. Which form should this employer file?

A. Form 941, Employer's Quarterly Federal Tax Return

B. Form 940, Employer's Annual Federal Unemployment Tax Return
C. Form 943, Employer's Annual Tax Return for Agricultural Employees
D. Form 944, Employer's Annual Federal Tax Return

73. A self-employed graphic designer uses the actual expense method for her home office deduction. Her allowable home office expenses for the year exceed the gross income limitation attributable to that business use, so a portion cannot be deducted in the current year. What happens to the disallowed portion?

A. It is permanently lost and can never be deducted in any tax year
B. It must be amortized in equal amounts over the following five tax years
C. It is deductible in full on Schedule A as a miscellaneous itemized deduction
D. It carries forward and may be deducted in a future year, subject to that year's income limit

74. A sole proprietor elects the simplified method for her home office deduction, claiming $5 per square foot instead of tracking actual expenses. She itemizes deductions on Schedule A. How should she treat her mortgage interest and real estate taxes on the home for the year?

A. She must allocate them between Schedule A and the business and cannot deduct either in full
B. She may not deduct mortgage interest or real estate taxes at all under the simplified method
C. She may deduct the full mortgage interest and real estate taxes on Schedule A, unallocated
D. She must add both amounts into the $5 per square foot simplified method calculation

75. A self-employed accountant purchases a new passenger automobile weighing under 6,000 pounds for $45,000, using it 100% for business, and claims 100% bonus depreciation in the first year. Under Section 280F, how does the luxury automobile depreciation limitation affect her first-year deduction?

A. Her first-year deduction is capped at the indexed Section 280F dollar limit for passenger automobiles, regardless of the vehicle's actual cost.
B. Her first-year deduction is unlimited because 100% bonus depreciation overrides the Section 280F luxury automobile caps entirely.
C. Her first-year deduction is capped only if she also claims the standard mileage rate in the same tax year.

D. Her first-year deduction is capped at 50% of the vehicle's cost, regardless of any bonus depreciation election made.

76. A sole proprietor has used the standard mileage rate to deduct her business vehicle expenses every year she has owned and used the car for business. When she later sells the vehicle, how does her consistent use of the standard mileage rate affect her adjusted basis in the vehicle?

A. Her basis is unaffected because the standard mileage rate does not include any depreciation component
B. Her basis must be reduced by the deemed depreciation portion built into the mileage rate for each year
C. Her basis is increased each year by the depreciation component embedded in the mileage rate
D. Her basis is irrelevant because standard mileage rate vehicles are exempt from gain or loss on sale

77. A self-employed sales representative wants to substantiate her business travel expenses. Under the strict substantiation rules of Section 274(d), which of the following expenses requires documentary evidence, such as a receipt, regardless of how small the amount is?

A. Any business meal expense under $75 paid in cash at a local restaurant
B. Any lodging expense, no matter how small the amount actually paid was
C. Any local transportation fare paid entirely in cash without a printed receipt
D. Any minor incidental expense such as a small tip paid to hotel staff

78. A business maintains all of its tax records exclusively in electronic form, having scanned and then destroyed the original paper source documents. Under Rev. Proc. 97-22, what must the business's electronic storage system generally be able to do for the records to satisfy IRS recordkeeping requirements?

A. Index, store, preserve, retrieve, and reproduce the electronic records in legible form for as long as they remain material.
B. Convert all electronic records back into original paper form within 24 hours of any IRS examination request.

C. Store records exclusively on IRS-approved third-party servers located within the United States for the full retention period.
D. Maintain records electronically only if the business also keeps a parallel complete paper backup copy of everything scanned.

79. A corporation generated a net operating loss in Year 1 and carried it forward to fully offset taxable income in Year 6, the year the loss was completely absorbed. For how long must the corporation retain the records substantiating the amount of the Year 1 net operating loss?

A. Only for three years after the close of Year 1, when the loss originally arose
B. Only for four years after the close of Year 1, matching general payroll record rules
C. Only until Year 6 begins, since the carryforward period itself establishes the retention period
D. Until the period of limitations expires for Year 6, the year the loss was used

80. A trust is treated as wholly owned by a single grantor under the grantor trust rules. To relieve the trustee of the burden of filing a full Form 1041, which alternative reporting method under Reg. Section 1.671-4 is available?

A. The trustee files a full Form 1041 but omits every beneficiary Schedule K-1
B. The trustee substitutes Form 1120 for Form 1041 as the trust's annual return
C. The trustee gives payors the grantor's taxpayer ID so income is reported directly to the grantor
D. The trustee substitutes Form 990-EZ for Form 1041 as the trust's annual return

81. On February 20, within 65 days after the close of its prior tax year, the trustee of Ashworth Family Trust makes a $40,000 distribution to a beneficiary. The trustee wants this distribution treated as if made on the last day of the prior tax year for purposes of the trust's distribution deduction. What allows this treatment?

A. The trustee must obtain the beneficiary's written consent before any distribution timing election becomes effective for tax purposes.
B. The Section 663(b) election, which treats a distribution made within 65 days after year-end as made in the prior year.

C. The trustee automatically receives this treatment for any distribution made before the extended due date of the trust's return.

D. The generation-skipping transfer tax annual exclusion, which allows retroactive dating of distributions made early in the following year.

82. A tax-exempt university operates a bookstore on campus that sells textbooks, school supplies, and sundries primarily to its own students and faculty. Although the bookstore generates a profit, why is this activity generally excluded from unrelated business taxable income?

A. The bookstore qualifies for the volunteer labor exception because most staff are unpaid students

B. The bookstore qualifies for the donated merchandise exception because most items are donated goods

C. The bookstore qualifies for the convenience exception for sales primarily serving students and employees

D. The bookstore qualifies for the passive income exception because merchandise sales generate royalty income

83. James, a participant in his employer's 401(k) plan, takes a $30,000 plan loan repayable over five years through payroll deduction. After a job change, James stops making loan payments entirely and the outstanding balance is never cured within the permitted cure period. What is the tax consequence?

A. The plan must forgive the loan balance without any tax consequence to James

B. James must repay the loan in full within ten years or forfeit his account

C. The plan automatically converts the loan into a new plan with extended terms

D. The unpaid loan balance becomes a taxable deemed distribution reportable to James that year

84. A commercial fruit grower has average annual gross receipts of $30 million and produces citrus trees with a pre-productive period of more than two years. Which statement correctly describes the grower's obligation under the uniform capitalization (UNICAP) rules of Section 263A?

A. The grower must capitalize preproductive costs but may elect out using ADS depreciation instead

B. The grower is automatically exempt from UNICAP because farming income is Schedule F income

C. The grower must capitalize preproductive costs with no election-out option ever available

D. The grower may deduct all preproductive costs currently regardless of gross receipts size

85. Maria actively participates in a single rental real estate activity, is not a real estate professional, and has modified adjusted gross income (MAGI) of $120,000 for the year, generating a $20,000 rental loss. How does the $25,000 special allowance apply?

A. Maria may deduct the full $25,000 allowance regardless of her MAGI this year
B. Maria may deduct none of the loss because her MAGI exceeds $100,000 entirely
C. Maria's allowance phases out and she may deduct only a partial amount of the loss
D. Maria may deduct the loss in full only if she elects real estate professional status

86. Sam invests $50,000 cash in a real estate limited partnership. Of that amount, $20,000 was borrowed from his brother, who has no other interest in the partnership except as a lender. How does this loan affect Sam's amount at risk under Section 465?

A. The $20,000 does not increase Sam's at-risk amount because his brother is a related party
B. The $20,000 fully increases Sam's at-risk amount because it is a recourse loan to Sam
C. The $20,000 fully increases Sam's at-risk amount since it qualifies as third-party financing
D. The $20,000 does not increase Sam's at-risk amount because the loan was undocumented

87. A tax-exempt hospital operates two clearly separate unrelated trades or businesses: a parking garage open to the general public and a for-profit medical equipment rental operation. The garage generates a loss while the equipment rental generates income. Under current law, how must the hospital compute its UBTI?

A. The hospital nets the garage loss against the equipment rental income on one combined return
B. The hospital may carry the garage loss back three years against equipment rental income
C. The hospital deducts the garage loss only if both businesses share the same NAICS code
D. The hospital must compute UBTI separately for each business, without netting losses between them

88. For 2024, an employee under age 50 defers salary into her employer's traditional 401(k) plan. Under Section 402(g), what is the maximum elective deferral she may contribute for the year?

A. $69,000, the overall Section 415(c) limit on total annual additions to the account
B. $23,000, the Section 402(g) statutory limit on elective salary deferrals for the year
C. $7,000, the limit that applies only to traditional and Roth IRA contributions combined
D. $16,000, the limit that applies only to SIMPLE IRA elective deferral contributions

89. Robert, age 68, is retired from his farming operation but continues to receive annual Conservation Reserve Program (CRP) payments on land he still owns. Robert also receives Social Security retirement benefits. How are the CRP payments generally treated for self-employment tax purposes?

A. The CRP payments are always fully subject to self-employment tax regardless of Robert's status
B. The CRP payments are entirely exempt because CRP income is investment income, not farm income
C. The CRP payments are exempt from self-employment tax because Robert receives Social Security benefits
D. The CRP payments are subject to self-employment tax only if Robert farms the land himself

90. A newly formed public charity projects annual gross receipts of no more than $50,000 and total assets of no more than $250,000. Which application may it file to obtain streamlined recognition of tax-exempt status?

A. Form 1023-EZ, the streamlined application available to smaller qualifying organizations
B. Form 1023, the standard long-form application required for all organizations equally
C. Form 990-N, the electronic postcard used to request exemption recognition
D. Form 1024-A, the application reserved for Section 501(c)(4) organizations only

91. Dr. Lin, a physician with no other involvement in the oil and gas industry, purchases a working interest in an oil well operated by a general partnership, holding the interest directly rather than through a limited partnership entity. She does not materially participate in operations. How are losses from this working interest treated under the passive activity rules?

A. The losses are passive because Dr. Lin does not materially participate in the well
B. The losses are passive because the operation is conducted through a general partnership entity
C. The losses are disallowed entirely because a working interest cannot generate deductible losses
D. The losses are nonpassive under the working interest exception regardless of material participation

92. For 2024, an employer must identify which employees are highly compensated employees (HCEs) to run nondiscrimination testing on its 401(k) plan. Under Section 414(q), which employee generally qualifies as an HCE?

A. An employee who owned more than 5% of the company at any point during the year or prior year
B. An employee who worked more than 1,000 hours during the plan year for the employer
C. An employee who is a member of the employer's board of directors only
D. An employee who has been continuously employed by the company for over ten years

93. A farmer's Schedule F shows net farm profit of only $300 for the year, which would normally translate into minimal Social Security earnings credit. What election allows the farmer to report a higher amount of self-employment earnings for Social Security purposes despite the low actual profit?

A. The farmer may elect to amend three prior years of Schedule F to smooth income
B. The farmer may elect the farm optional method to report a higher deemed SE income
C. The farmer may elect income averaging on Schedule J to raise reported SE earnings
D. The farmer may elect to convert the farm to an S corporation retroactively for SE purposes

94. A separately incorporated entity is organized and operated for the primary purpose of carrying on a trade or business for profit, even though all of its net profits are turned over to an affiliated Section 501(c)(3) charity. Under Section 502, how is this entity classified?

A. The entity is exempt because its profits are ultimately dedicated entirely to charitable use
B. The entity is a supporting organization because it exists to benefit the affiliated charity
C. The entity is a taxable feeder organization despite transferring all profits to the charity
D. The entity is treated as a branch of the charity and files a combined return

95. A single-employer defined benefit pension plan's actuary determines that plan assets are insufficient to satisfy the plan's minimum funding requirement for the year, resulting in a funding deficiency. What consequence applies to the employer under Section 4971?

A. The employer loses the plan's qualified status permanently with no cure period allowed

B. The plan must terminate immediately and distribute all accrued benefits to participants

C. The employer must convert the plan to a defined contribution plan within 90 days

D. The employer is subject to an excise tax on the amount of the funding deficiency

96. Two co-owners jointly operate a small business activity together, with no other individuals involved. One owner participates 450 hours during the year while the other participates only 80 hours. Under which material participation test does the first owner satisfy material participation?

A. The 500-hour regular and continuous participation test based on total annual hours logged

B. The substantially-all-participation test since her hours constitute nearly all participation by anyone

C. The five-of-ten-years historical participation test based on prior taxable year involvement

D. The facts-and-circumstances test applied only when no other test can be satisfied

97. A farmer pays his 16-year-old daughter for helping with harvest by giving her raised corn from the farm's inventory rather than cash wages, and she then sells the corn herself to a grain elevator. What is the primary tax advantage of this commodity wage arrangement?

A. The in-kind wage payment avoids Social Security, Medicare, and federal unemployment tax withholding

B. The in-kind wage payment converts the daughter's earnings into tax-exempt gift income entirely

C. The in-kind wage payment allows the farmer to skip issuing any Form W-2 or 1099

D. The in-kind wage payment lets the farmer deduct double the corn's fair market value

98. In a divorce proceeding, a state court issues an order assigning a portion of Michael's qualified retirement plan benefits directly to his former spouse. If this order meets all statutory requirements to be treated as a QDRO, what tax result generally follows for a distribution paid directly to the former spouse?

A. Michael remains taxable on the entire distribution regardless of who actually receives the funds

B. The distribution is entirely tax-free income to the former spouse under any circumstances

C. The former spouse, as alternate payee, is generally taxed on the distribution she receives

D. The distribution is subject to the 10% early distribution penalty even though a QDRO applies

99. A nonprofit organization derives most of its revenue from fees charged for admission, sales of merchandise related to its exempt purpose, and performance of services, rather than from gifts, grants, and contributions. Under which public charity test is this organization most appropriately classified?

A. The Section 509(a)(1) donative public support test relying primarily on gifts and grants received
B. The Section 509(a)(2) gross receipts test covering exempt function fee and service revenue
C. The Section 509(a)(3) supporting organization test requiring a relationship to another public charity
D. The private operating foundation test requiring direct conduct of the organization's own programs

100. A rental real estate activity generated suspended passive losses for Karen in prior years while it remained passive. This year, Karen begins materially participating in the activity, causing it to become nonpassive going forward. How are her prior suspended losses from this now-former passive activity treated this year?

A. The suspended losses are permanently forfeited once the activity becomes nonpassive going forward
B. The suspended losses may only offset passive income from other unrelated passive activities
C. The suspended losses must be carried forward indefinitely until the activity is fully disposed
D. The suspended losses are allowed against this year's income from the same activity

Answer Key and Explanations — Practice Exam 21, Part 2: Businesses

1. A — Syndication costs under Section 709 include commissions, printing, and legal fees connected with promoting and marketing partnership interests to investors. Unlike organizational expenditures, which may be partially deducted and amortized over 180 months, syndication costs receive no current deduction and no amortization; they must simply be capitalized permanently, distinguishing them from the more favorable organizational-expense rules.

2. D — LLC members are not automatically treated as limited partners for self-employment tax purposes. Courts and the functional test in proposed regulations look at personal liability, authority to bind the entity, and participation in management. Because Priya has liability exposure, contracting authority, and manages operations full-time, she functions like a general partner, so her distributive share is subject to self-employment tax.

3. B — Under Section 705 and its regulations, a partner's outside basis is increased for the year's distributive share of income before it is decreased for distributions. Applying income first raises Elias's basis to $16,000, so the $14,000 distribution does not exceed basis and no gain is recognized under Section 731; reversing the order would have incorrectly triggered gain.

4. C — Ordinarily, a Section 734(b) basis adjustment applies only with a valid Section 754 election. However, Section 734(d) overrides that requirement when a distribution causes a substantial basis reduction exceeding $250,000: the partnership must make the downward adjustment to its remaining property regardless of any election, preventing partners from avoiding mandatory basis-shifting rules through inaction.

5. A — Because nonrecourse deductions are not matched to any partner's economic risk of loss, they cannot satisfy the substantial-economic-effect test directly. Instead, the Section 704(b) regulations provide a separate safe harbor requiring, among other conditions, a minimum gain chargeback provision, ensuring that if partnership minimum gain later decreases, income is allocated to offset the earlier nonrecourse deductions taken.

6. B — Section 704(e) recognizes a donee as a partner only if the gift is complete and the donee is the real owner of the capital interest. Because the father retained the power to revoke the transfer and redirect distributions to himself, he never relinquished dominion and control, so the daughter is not recognized as the true owner for tax purposes.

7. D — Section 465(b)(6) provides a narrow exception allowing qualified nonrecourse financing secured by real property to increase a taxpayer's amount at risk, even without personal liability. This exception does not extend to equipment leasing or other non-real-property activities, so ordinary nonrecourse financing on leased equipment remains excluded from Foster's at-risk amount under the general at-risk computation rules.

8. C — Section 6221(b) allows a partnership with 100 or fewer partners, all of whom are eligible partners such as individuals or corporations, to elect out of the centralized partnership audit regime. The election is not automatic; it must be made affirmatively each year on a timely filed return, and any partnership or trust partner disqualifies the election.

9. C — Upon a Section 708(b)(1) termination, the partnership's taxable year closes for every partner on the termination date, not just for partners who sold or disposed of interests. A short-period return must be filed reporting all partnership items through that date, and every partner, including Kowalski, must report her distributive share for that short period.

10. A — Section 761(f) permits spouses who are the only members of a jointly owned and operated unincorporated business, and who both materially participate, to elect qualified joint venture treatment. Instead of filing a partnership return, each spouse reports a proportionate share of income, deductions, and self-employment tax on a separate Schedule C, regardless of state property law.

11. D — Under Section 465(a)(2), a loss disallowed because it exceeds the taxpayer's amount at risk in the activity is not permanently lost. It is carried forward indefinitely and treated as a deduction from that same activity in the first succeeding tax year in which the taxpayer's amount at risk increases enough to absorb the previously suspended loss.

12. B — Because the premiums are paid under a plan established by the partnership for a partner treated as self-employed, the guaranteed payment is included in Nkemdirim's gross income and remains subject to self-employment tax, unlike an employee's excludable health coverage. She may separately claim the self-employed health insurance deduction above the line on her own return.

13. C — Under Section 732(a)(1), a partner's basis in property received in a nonliquidating distribution generally equals the partnership's adjusted basis in that property immediately before distribution, limited to but never automatically stepped up to her outside basis. Even though Castillo has ample remaining basis, she still takes the carryover $18,000 basis, not a higher stepped-up amount.

14. A — Under Section 6226, a timely push-out election shifts responsibility for the adjustment away from the partnership itself and onto the partners who held interests during the reviewed year. Each such partner receives a statement and must report her allocable share of the adjustment on her own return for the reporting year, paying any additional tax plus a higher interest rate.

15. B — The farm optional method under Section 1402(a) allows a farmer whose gross farm income is below the annually indexed threshold to report two-thirds of gross farm income, capped at the maximum optional amount for that year, as net earnings from self-employment. This can produce higher reported earnings than actual profit, increasing Social Security quarters of coverage.

16. D — Under Section 752(b), a decrease in a partner's share of partnership liabilities is treated as a deemed distribution of money. Combined with the $5,000 actual cash, Iyer is treated as receiving $14,000 total against her $11,000 outside basis, producing $3,000 of capital gain under Section 731(a)(1) upon complete liquidation of her interest.

17. B — Under Revenue Ruling 69-184, a partner cannot simultaneously be treated as an employee of the same partnership for federal employment tax purposes, regardless of how the payments are labeled. All compensation Whitfield receives for services must instead be treated as a distributive share or guaranteed payment, subject to self-employment tax rather than FICA withholding on a Form W-2.

18. D — The partnership representative's authority is a matter of federal tax procedure, not state partnership law, and the designation remains effective and exclusive until properly changed. Internal partner disagreement alone does not revoke that authority; the partnership must follow the regulatory procedures for designating a successor, and until it does, the IRS continues corresponding solely with the incumbent representative.

19. C — A person who receives stock solely for services is not a 'transferor' under Section 351 and is excluded entirely from the control group; only stock issued for property counts. Reyes's stock is taxable compensation to him. Because Underwood, Voss, and Patel alone hold 82% control, their property transfers still qualify for nonrecognition.

20. A — Distributions are dividends to the extent of E&P ($40,000), taxed as ordinary income. The remaining $30,000 is applied against stock basis as a tax-free return of capital, but only $25,000 of basis exists, so it is exhausted. The final $5,000 exceeds both E&P and basis and is taxed as capital gain.

21. A — Under Section 311(b), a corporation recognizes gain (but not loss) when it distributes appreciated property to a shareholder, as though the property were sold at fair market value immediately before the distribution. Bristol Corp recognizes $35,000 of gain ($90,000 minus $55,000 basis). The shareholder takes a fair market value basis in the land.

22. B — AAA is adjusted for the year's income items before it is reduced by distributions. The $30,000 of ordinary income first increases AAA from $10,000 to $40,000. The $35,000 distribution is then applied against the $40,000 balance, reducing AAA to $5,000, which determines the tax-free portion of the distribution to shareholders.

23. C — Straight debt meeting the statutory safe harbor—an unconditional written promise to pay a sum certain on demand or a fixed date, non-contingent interest, no convertibility, and held by an eligible person—is not treated as a second class of stock under Section 1361(c)(5), so the S election remains valid despite the outstanding note.

24. D — Section 1244 allows an ordinary loss deduction on qualifying small business stock, capped at $100,000 for married taxpayers filing jointly ($50,000 for other filers), regardless of the total loss sustained. Priya may deduct $100,000 as an ordinary loss; the remaining $20,000 is a capital loss, subject to the usual capital loss limitations.

25. B — When a shareholder's debt basis has been reduced by pass-through losses, repayment of the loan is treated as a payment on a debt instrument with basis lower than its face amount. The excess of the amount received over the reduced basis, $8,000 here, is recognized as gain, generally capital gain if the note is a capital asset.

26. A — The personal holding company tax under Section 541 is imposed on a corporation's undistributed PHC income at the maximum rate applicable to net capital gain for individuals, currently 20%. This penalty tax, separate from the corporation's regular income tax, encourages closely held corporations with substantial passive income to distribute earnings to shareholders rather than accumulate them.

27. C — A Type E reorganization under Section 368(a)(1)(E) is a recapitalization—a reshuffling of a single corporation's capital structure, such as exchanging bonds for stock or one class of stock for another. It involves only one corporation, unlike Types A, B, C, and D, which require an acquisition involving a second corporation.

28. D — Section 368(a)(1)(C) generally requires that the acquiring corporation obtain substantially all of the target's assets solely in exchange for voting stock. However, Section 368(a)(1)(C) itself provides that the assumption of the target's liabilities is disregarded in determining whether this solely-for-voting-stock requirement is satisfied, so Acquiring's assumption of Target's debts does not disqualify the reorganization.

29. B — When a corporation transfers assets to a controlled corporation and then liquidates, distributing the new corporation's stock to its shareholders, but the transaction fails the Section 355 divisive requirements, it is treated as a nondivisive (acquisitive) Type D reorganization under Section 368(a)(1)(D), with gain recognition governed by reorganization rather than liquidation provisions.

30. D — Every C corporation other than a personal service corporation is entitled to a minimum accumulated earnings credit equal to $250,000 reduced by beginning-of-year accumulated E&P, but not below zero; personal service corporations use a $150,000 threshold instead. This credit protects reasonable working capital reserves without requiring the corporation to document specific future business needs.

31. A — Section 1563(a)(2) defines a brother-sister controlled group as two or more corporations where five or fewer persons who are individuals, estates, or trusts own at least 80% of each corporation's stock, and their identical ownership across all corporations, using each person's lowest common percentage, exceeds 50%. Because both tests are satisfied here, Acorn and Birch form a brother-sister controlled group.

32. C — An eligible LLC that timely files Form 2553 to elect S corporation status is not separately required to file Form 8832. The IRS treats a valid Form 2553 as a deemed election of association (corporate) status effective as of the S election's effective date, combining both elections into the single Form 2553 filing.

33. C — Section 1374 caps the aggregate amount subject to built-in gains tax over the entire recognition period at the corporation's net unrealized built-in gain (NUBIG) determined as of the conversion date. Even though $95,000 of gain was actually recognized, only $80,000—the NUBIG ceiling—can ever be taxed under Section 1374, regardless of how much gain is recognized.

34. B — Section 332 nonrecognition applies only to a distributee corporation owning at least 80% of the liquidating subsidiary's stock. Wells, an unrelated minority shareholder, does not meet this ownership requirement, so he is taxed under the general liquidation rule of Section 331: he recognizes gain or loss as if he sold his stock for the property's fair market value.

35. A — Controlled group status, and whether a corporation is a component member entitled to share the group's single set of graduated brackets and accumulated earnings credit, is generally tested as of December 31 of the corporation's tax year (or the last day of a short year), reflecting ownership on that specific testing date rather than averaged throughout the year.

36. D — Section 108(a)(1)(B) excludes canceled debt from gross income to the extent the taxpayer is insolvent immediately before the cancellation, measured as liabilities exceeding the fair market value of assets. Because Larkin's insolvency of $80,000 ($340,000 minus $260,000) exceeds the $50,000 canceled, the entire amount is excluded from income, though Larkin must reduce certain tax attributes by the excluded amount.

37. B — Under Section 1033, gain on an involuntary conversion is deferred to the extent proceeds are reinvested in qualifying replacement property within the replacement period. Realized gain is $80,000

($260,000 minus $180,000 basis), but recognized gain is limited to unreinvested proceeds. Redstone reinvested $250,000 of the $260,000 received, leaving $10,000 unreinvested, so only $10,000 of gain must be recognized.

38. D — Section 475 requires a securities dealer that elected mark-to-market accounting to treat securities as sold for fair market value on the year's last business day, recognizing gain or loss currently. Unlike capital gain treatment for investors, gains and losses under Section 475 are ordinary in character, so Vantage reports the $90,000 as ordinary income though no sale occurred.

39. A — Farmers and fishermen may elect income averaging by treating part of the current year's farm income as if earned evenly over the three prior base years, reducing the rate spike from an unusually high year. The election is made on Schedule J, filed with Form 1040, unrelated to accounting method changes or schedules reporting farm income and expenses.

40. C — Under Section 7872, a below-market loan between a shareholder and corporation exceeding the $10,000 de minimis exception is recharacterized: the lender is treated as receiving imputed interest income at the applicable federal rate, and the corporation is treated as making a corresponding distribution to the shareholder, not as a gift or debt cancellation income.

41. A — Section 461(l) limits the amount of net business losses an individual may deduct against nonbusiness income each year (indexed annually). Losses exceeding the threshold are not lost; they are disallowed for the current year but carried forward and treated as part of the taxpayer's net operating loss carryforward, deductible in future years subject to NOL limitations.

42. C — Barter exchange transactions are taxable in the year property or services are provided, regardless of when barter credits are actually spent. A barter exchange must report the fair market value of credits received on Form 1099-B, and Willow must include that fair market value in gross income for the year the credits are earned, not deferred until redemption.

43. D — Section 1245 recaptures depreciation claimed on personal property such as equipment as ordinary income upon sale, up to the lesser of the recognized gain or the total depreciation taken. Turlock recognized a $45,000 gain ($95,000 minus $50,000 basis), which is fully absorbed by the $70,000 of depreciation claimed, so the entire $45,000 gain is ordinary income.

44. B — The Section 1231 lookback rule requires that current-year net Section 1231 gain be treated as ordinary income to the extent of any nonrecaptured Section 1231 losses deducted in the prior five years. Bellamy's unrecaptured losses total $35,000 ($20,000 plus $15,000), so $35,000 of the 2026 gain is ordinary income and the remaining $15,000 is long-term capital gain.

45. A — Certain liabilities, including workers' compensation and tort claims, are designated payment liabilities under Section 461(h) regulations, meaning economic performance occurs only when the business actually pays the claimant. The recurring item exception does not apply to these liabilities regardless of the accrual method used. Because Iron Gate paid the claim in February 2026, the deduction is allowed only in 2026.

46. C — A corporation that is not a large corporation may avoid the estimated tax underpayment penalty by paying installments equal to the lesser of 100% of the current year's tax or 100% of the tax shown on its prior year return, provided that return covered a full twelve months and showed a positive tax liability, as Bramwell's 2025 return did.

47. B — Section 1239 recharacterizes gain from the sale of depreciable property between related parties, including a more-than-50%-owned corporation, as ordinary income rather than capital gain, when the property is depreciable in the buyer's hands. Because Cedar Corp is wholly owned by Nolan and will depreciate the equipment, the entire $40,000 gain is ordinary income, not capital gain.

48. D — Under the tangible property regulations, a cost must be capitalized if it results in a betterment, restoration, or adaptation to a new use of the unit of property. Replacing an entire roof structure after damage, restoring the building to like-new condition and extending its useful life, is a restoration under Reg. Section 1.263(a)-3, requiring capitalization rather than a current deduction.

49. A — A security deposit that the landlord is unconditionally obligated to refund is not includible in income when received, since the tenant retains an equitable claim to it. Advance rent, however, is includible in gross income in the year received regardless of accounting method or the period to which it applies, so Fairview reports the $1,800 as income immediately.

50. D — Section 197 intangibles, including purchased goodwill, going-concern value, and similar assets acquired in connection with the acquisition of a trade or business, must be amortized ratably over a fixed 15-year period using the straight-line method, regardless of the intangible's actual economic useful life or any appraisal suggesting a shorter or longer period.

51. C — The One Big Beautiful Bill Act permanently restored 100% bonus depreciation for qualified property acquired and placed in service after January 19, 2025, reversing the scheduled phase-down that had reduced the rate to 40% for 2025 under prior law. Because Titan's property met both the acquisition and placed-in-service dates, it qualifies for full 100% first-year expensing.

52. B — Once business use of Section 179 property falls to 50% or less before the recovery period ends, the taxpayer must recapture as ordinary income the excess of the Section 179 deduction claimed over the depreciation that would have been allowable using the regular MACRS method. No amended return or exchange treatment applies; recapture is reported in that year.

53. D — Office furniture, fixtures, and equipment not otherwise classified fall under MACRS asset class 00.11, which carries a 7-year recovery period using the 200% declining balance method (switching to straight-line) under the General Depreciation System. Computers and typewriters use 5-year property, while land improvements use 15 years and nonresidential buildings use 39 years.

54. A — For a non-SSTB taxpayer whose taxable income exceeds the phase-in range, the QBI component is limited to the greater of 50% of W-2 wages paid by the business, or 25% of W-2 wages plus 2.5% of the UBIA of qualified property. This wage and capital limit prevents the deduction from applying without sufficient wage or capital investment.

55. B — Section 38(d) requires that the general business credit be applied in a specific order: carryforwards are used first, beginning with the earliest tax year, followed by the current year's separately computed general business credit amount. This first-in, first-out ordering prevents older carryforwards from expiring unused while the taxpayer applies more recently generated credits.

56. C — Although engineering and architecture services were listed as specified service trades or businesses under prior proposed guidance, the final Section 199A regulations specifically exclude engineering and architecture from the SSTB definition. Renata's firm is therefore a qualified trade or business, and her deduction is instead limited only by the wage and UBIA-based capital limitation, since her income exceeds the threshold.

57. C — Section 195 allows an immediate deduction of up to $5,000 in start-up expenditures, reduced dollar-for-dollar once total costs exceed $50,000. Because Priya's $48,000 in costs stayed under that threshold, the full $5,000 is deductible in 2025, and the remaining $43,000 must be amortized ratably over 180 months, beginning with the month the bakery opened for business.

58. B — Reasonable compensation paid by an S corporation to a shareholder-employee for services rendered is treated as wage income to the shareholder, not as qualified business income, regardless of the shareholder's taxable income level. However, that same compensation still counts as W-2 wages of the business for purposes of computing the wage-based limitation on the QBI deduction.

59. A — Section 41 specifically excludes research conducted after the beginning of commercial production of the business component, as well as activities such as routine quality control testing and adaptations for a particular customer's taste or style preference. Because the fine-tuning occurred after commercial production began and involved routine and cosmetic adjustments, those costs cannot be treated as qualified research expenses.

60. D — To claim the Work Opportunity Tax Credit, the employer and the new employee must complete Form 8850 by the day a job offer is made, and the employer must then submit it to the state workforce agency no later than 28 days after the employee begins work. Missing this deadline generally disqualifies the employer from claiming the credit.

61. A — Under the passive activity credit rules, general business credits generated by an activity in which the taxpayer does not materially participate can generally only offset the tax liability attributable to income from that taxpayer's passive activities, not tax on wages or portfolio income. Because the partner has no passive income this year, the credit is suspended and carried forward.

62. C — Qualified business income does not include items treated as capital gain or loss, and a Section 1231 gain that is characterized as long-term capital gain falls within that exclusion even though it arose from a trade or business asset. Only the portion of gain, if any, taxed as ordinary income under depreciation recapture rules would remain includible in QBI.

63. D — The mid-quarter convention applies only to personal property and compares fourth-quarter personal-property basis to the year's total personal-property basis; real property is excluded from that test. Nonresidential real property and residential rental property are instead always depreciated using the mid-month convention, regardless of when personal property triggers mid-quarter treatment for other assets.

64. B — For Section 179 purposes, married taxpayers filing separate returns are treated as one taxpayer, and the dollar limitation is split equally between them, 50% each, unless both spouses elect a different allocation percentage that adds up to 100%. This prevents spouses from doubling the limitation simply by filing separate returns instead of jointly.

65. C — For QBI purposes, qualified property remains within its depreciable period, and its UBIA still counts toward the wage and capital limitation, until the later of the end of its MACRS recovery period or 10 years after being placed in service. Since only nine years have passed, this equipment remains within its extended depreciable period at its original unadjusted basis.

66. B — When an employee works for more than one employer during the year and each properly withholds Social Security tax up to the wage base, the combined withholding can exceed the annual maximum. The employee, not the employers, corrects this by claiming the excess as a refundable credit against income tax liability on Form 1040, rather than seeking employer refunds.

67. D — A business becomes subject to FUTA for the year if it paid wages of $1,500 or more to employees during any calendar quarter, or employed at least one worker for some portion of a day in each of 20 different calendar weeks. Paying $1,800 to one employee in a single quarter satisfies the wage test alone, regardless of employee count.

68. A — Section 6672 imposes the Trust Fund Recovery Penalty, equal to unpaid withheld income and FICA taxes, on any responsible person who willfully fails to collect, account for, or pay over those funds. Because the controller had authority over payments and knowingly diverted withheld taxes to other creditors, she is a responsible person subject to personal liability for the full amount.

69. C — Under the relationship-of-the-parties category of the common law test, the right to discharge a worker at will, without incurring liability for breach of contract, strongly indicates an employer-employee relationship. Independent contractors are typically engaged for a specific result and cannot be terminated early without exposing the business to liability, unlike employees, who serve at the employer's discretion.

70. A — Semiweekly depositors must deposit employment taxes on wages paid Wednesday, Thursday, or Friday by the following Wednesday, giving three banking days after the deposit period ends. Wages paid Saturday through Tuesday instead must be deposited by the following Friday. Because this employer paid wages on a Friday, the deposit is due the following Wednesday, not immediately or the next Friday.

71. B — Organizations recognized as exempt from federal income tax under Section 501(c)(3) are statutorily exempt from FUTA on wages paid to their employees, regardless of employee count or wage amounts. These organizations instead typically become liable for state unemployment tax under state law, or may elect to reimburse the state fund for benefits paid, rather than paying the federal unemployment tax.

72. D — Very small employers with an estimated annual employment tax liability of $1,000 or less may be notified by the IRS that they qualify to file Form 944 annually instead of Form 941 quarterly, reducing their filing burden. An employer may not simply switch to Form 944 on its own; it must receive written IRS notification or request approval.

73. D — Home office expenses under the actual expense method are deductible only up to the gross income from that business use, after other allocable deductions. Any disallowed excess is not lost; it carries forward indefinitely and may be deducted in a later year, subject again to that later year's own gross income limitation.

74. C — Under the simplified method, the $5-per-square-foot rate already accounts for home office expenses in place of actual costs, and depreciation is not separately claimed. However, mortgage interest and real estate taxes are treated differently: the taxpayer may still deduct the full allowable amounts as itemized deductions on Schedule A, without allocating any portion to the business.

75. A — Section 280F imposes annual dollar caps on depreciation for passenger automobiles weighing 6,000 pounds or less, including an elevated but still capped first-year amount when bonus depreciation is claimed. Even though she elected 100% bonus depreciation, her deduction cannot exceed the indexed first-year luxury auto limit, with excess cost recovered in later years under the regular schedule.

76. B — The standard mileage rate is composed of several cost components, including a deemed depreciation allowance that varies by year. Even though she never separately calculates or claims MACRS depreciation, she must still reduce her adjusted basis in the vehicle each year by that embedded amount, which affects the gain or loss recognized when the vehicle is eventually sold.

77. B — Section 274(d) generally requires documentary evidence, such as receipts, for lodging expenses regardless of the dollar amount involved. Many other travel expenses, such as meals or incidental costs under $75, may instead be substantiated through the taxpayer's own contemporaneous account book or log without a receipt. Lodging is treated more strictly because no de minimis exception applies to it.

78. A — Rev. Proc. 97-22 permits taxpayers to maintain books and records in electronic storage systems, provided the system indexes, stores, preserves, retrieves, and reproduces the records in legible, readable format for as long as they remain material to federal tax administration. There is no requirement to retain paper backups or convert records back to paper for an examination.

79. D — Records supporting a net operating loss must be kept not merely for the year the loss arose, but for as long as they remain material, which extends through every year the loss is carried forward, until the period of limitations expires for the year in which the loss is finally used to offset income, here Year 6.

80. C — Under the optional reporting method of Reg. Section 1.671-4(b)(2)(iii), a trustee of a wholly grantor-owned trust may furnish payors with the grantor's taxpayer identification number and address, causing income items to be reported directly to the grantor's own return. This eliminates the need to file a separate Form 1041, since all income is already attributed to the grantor personally.

81. B — Section 663(b) permits a trustee to elect to treat a distribution made within the first 65 days of a tax year as though made on the last day of the preceding tax year. This election lets the trust claim a distribution deduction sooner and shift taxable income to the beneficiary for the earlier year, rather than the year actually paid.

82. C — Section 513(a)(2) excludes from unrelated business income any trade or business carried on primarily for the convenience of an organization's members, students, patients, officers, or employees, such as a campus bookstore selling to its own student body. Volunteer labor and donated merchandise exceptions do not apply here since staffing and inventory sourcing were not described as such.

83. D — When a participant loan is not repaid according to its terms and the default is not cured within the permitted cure period, the outstanding balance is treated as a deemed distribution under Reg. Section 1.72(p)-1, taxable to the participant in the year of default, plus a 10% early distribution penalty if James is under 59½.

84. A — Farmers producing plants with a preproductive period exceeding two years are generally required to capitalize preproductive costs under Section 263A, but may elect out of UNICAP for that farming business. Making this election requires using the alternative depreciation system (ADS) for all property used predominantly in the farming business, trading capitalization for slower depreciation.

85. C — The $25,000 special allowance for active participants in rental real estate phases out ratably for MAGI between $100,000 and $150,000, reduced by 50% of the excess over $100,000. With MAGI of $120,000, the allowance shrinks to $15,000, so Maria may deduct only $15,000 of her $20,000 loss, with the remainder suspended.

86. A — Under Section 465(b)(3), amounts borrowed from a person related to the taxpayer generally do not increase the taxpayer's amount at risk, even if the taxpayer is personally liable for repayment, because such loans lack genuine economic risk. Since Sam's brother is a related party under Section 267(b), the $20,000 loan does not add to Sam's at-risk basis.

87. D — Section 512(a)(6), enacted by the Tax Cuts and Jobs Act, requires exempt organizations with more than one unrelated trade or business to compute unrelated business taxable income separately for each business, often called the 'silo' rule. A loss from the parking garage may no longer offset income from the equipment rental business; each is calculated independently.

88. B — Section 402(g) caps elective salary deferrals an employee may contribute to a 401(k) plan at $23,000 for 2024, separate from the overall Section 415(c) annual additions limit of $69,000, which includes employer contributions too. Option A confuses the deferral limit with the total contribution limit, while C and D describe unrelated plan types' limits entirely.

89. C — CRP payments are generally treated as self-employment income subject to SE tax; however, a statutory exception excludes CRP payments from SE tax for individuals already receiving Social Security retirement or disability benefits. Since Robert receives Social Security retirement benefits, his CRP payments are exempt from self-employment tax even though they remain taxable as ordinary income on his return.

90. A — Organizations projecting annual gross receipts of $50,000 or less and total assets of $250,000 or less generally qualify to file the streamlined Form 1023-EZ for expedited recognition of Section 501(c)(3) status. Form 990-N is only an annual information filing, not an exemption application, and Form 1024-A applies to Section 501(c)(4) organizations, not 501(c)(3) charities.

91. D — Section 469(c)(3) exempts a working interest in an oil or gas property held directly, or through an entity that does not limit the holder's liability, from the passive activity rules entirely. Because Dr. Lin holds the working interest directly with unlimited liability exposure, her losses are nonpassive and fully deductible against other income regardless of material participation hours.

92. A — Under Section 414(q), a highly compensated employee is generally anyone who was a more-than-5% owner of the business during the current or preceding year, or who received compensation exceeding the indexed statutory threshold in the preceding year. Hours worked, board membership, and tenure alone, described in the other options, do not independently establish HCE status under the statute.

93. B — The farm optional method allows a farmer with low or negative net farm profit to elect to report a higher deemed amount of self-employment earnings, up to a statutory ceiling, in order to preserve Social Security and Medicare earnings credits. Schedule J income averaging affects income tax liability only and has no effect on self-employment tax earnings history.

94. C — Section 502 provides that an organization operated primarily for the purpose of carrying on a trade or business for profit is denied exempt status as a 'feeder organization,' even if all of its profits are payable to one or more exempt organizations. The entity must file its own taxable corporate return; merely donating profits does not confer exemption.

95. D — Section 4971 imposes an excise tax on an employer maintaining a defined benefit plan that fails to satisfy the minimum funding standards, calculated on the accumulated funding deficiency. An initial 10% tax applies, escalating to 100% if the deficiency is not corrected within the statutory correction period, rather than triggering automatic disqualification or forced plan termination.

96. B — Because the first owner's 450 hours represent substantially all of the participation in the activity by any individual, including the co-owner and any non-owner workers, she satisfies the material participation regulatory test based on substantially all participation, even though she falls short of the 500-hour threshold under the first, separate regular and continuous participation test.

97. A — Wages paid to a farm employee in the form of a commodity, such as raised grain or livestock, rather than cash, are not subject to FICA, Medicare, or FUTA withholding, since employment taxes generally apply only to cash remuneration. The employee reports gain upon later sale of the commodity, and the farmer still deducts its fair market value.

98. C — A qualified domestic relations order (QDRO) is a statutory exception to the anti-alienation rule protecting qualified plan benefits, permitting assignment of benefits to an alternate payee. When a QDRO directs a distribution paid directly to the former spouse, she is generally taxed on that amount as the recipient, and the 10% early distribution penalty does not apply to her.

99. B — Section 509(a)(2) applies to organizations that receive more than one-third of their support from a combination of gifts, grants, and exempt-function revenue such as admissions, merchandise sales, and service fees related to their exempt purpose. This differs from the 509(a)(1) donative test, which measures support primarily from gifts, grants, and contributions rather than earned revenue.

100. D — Under the former passive activity rule of Section 469(f), suspended losses from an activity that was passive in a prior year but is nonpassive in the current year remain allowed, but only against income generated by that same activity in the current year, rather than being forfeited, applied elsewhere, or held indefinitely until a complete disposition occurs.