PRACTICE EXAM 23: 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. Marisol operates a sole proprietorship consulting business and separately owns a small residential rental property that she manages herself. For the current year, her consulting business generated $62,000 net profit, and the rental property produced $14,000 net rental income. How much of this income is subject to self-employment tax?

A. $76,000, because all income from a sole proprietor's activities is subject to SE tax

B. $62,000, because net rental real estate income is excluded from self-employment income under Section 1402(a)(1)

C. $14,000, because only passive rental income is subject to SE tax while active business income is not

D. $38,000, representing 50% of the combined income under a safe-harbor rental allocation rule

2. Devon, unmarried, owns a sole proprietorship manufacturing custom furniture (not an SSTB). His taxable income before the QBI deduction is $260,000, well above the applicable phase-in range. The business's QBI is $150,000, W-2 wages paid are $40,000, and unadjusted basis immediately after acquisition (UBIA) of qualified property is $60,000. What is his tentative QBI deduction, applying the wage/UBIA limitation?

A. $20,000, the greater of 50% of W-2 wages ($20,000) or 25% of wages plus 2.5% of UBIA ($11,500)

B. $30,000, computed as 20% of the full $150,000 QBI amount with no wage or UBIA limitation applied

C. $11,500, computed only as 25% of W-2 wages plus 2.5% of UBIA with no alternative comparison made

D. $40,000, equal simply to the full amount of W-2 wages paid by the business during the year

3. Priya's sole proprietorship purchased $95,000 of qualifying equipment and elected Section 179 expensing. Before considering the Section 179 deduction, her aggregate taxable income from the active conduct of all her trades or businesses (including wages) was $58,000. How much Section 179 expense may Priya deduct in the current year?

A. $95,000, the full cost of the equipment regardless of business income

B. $0, because Section 179 is entirely disallowed once taxable income falls below the asset cost

C. $37,000, the difference between the equipment cost and taxable income, treated as a penalty reduction

D. $58,000, limited to aggregate active-trade-or-business taxable income, with the $37,000 excess carried forward

4. Wallace, a sole proprietor with no employees, paid $9,600 in premiums during the year for a health insurance policy covering himself and his spouse, established under his business name. His Schedule C net profit was $45,000, and he was not eligible for any subsidized employer plan through his spouse. How should Wallace treat the $9,600?

A. As a fully deductible Schedule C business expense reducing net profit and SE tax

B. As a nondeductible personal expense, since sole proprietors cannot deduct their own health insurance

C. As an above-the-line deduction on Schedule 1, limited to net self-employment earnings, not reducing SE tax

D. As a guaranteed payment includible in his self-employment income for computing the deduction

5. Renata, single, operates a sole proprietorship that generated a $650,000 net business loss for the year, her only business activity, with no other income sources. Applying the excess business loss limitation (indexed threshold approximately $305,000 for a single taxpayer), what is the tax treatment of the loss?

A. The loss is limited to the applicable threshold amount, with the excess treated as a net operating loss carryforward

B. The entire $650,000 loss is fully deductible against other income in the current year

C. The loss is disallowed entirely and permanently lost, with no carryforward permitted at all

D. The loss is capped at $250,000 flat, regardless of filing status or the indexed threshold amount

6. Oscar raises show horses as a sole proprietorship activity, reporting losses in six of the last seven years, with a $22,000 loss this year. He keeps no separate business records, consults no experts, and pursues the activity primarily for personal enjoyment with no realistic profit expectation. Under Section 183, how should Oscar's expenses be treated?

A. Fully deductible against other income, since horse activities are a per se exception to hobby loss rules

B. Deductible only up to the activity's gross income, since the facts indicate it is not engaged in for profit

C. Fully deductible as ordinary Schedule C losses, since a history of losses alone is never disqualifying

D. Nondeductible entirely, including any expenses that would otherwise offset the activity's own gross income

7. Beatriz uses a 300-square-foot room in her home exclusively and regularly as her principal place of business for her sole proprietorship, in a home with 2,000 total square feet. She wants to compare her deduction under the simplified method versus the regular (actual expense) method. Which statement correctly describes a key difference between the two methods?

A. The simplified method allows a separate depreciation deduction in addition to the flat square-footage rate

B. The regular method caps the deduction at $5 per square foot regardless of actual home expenses

C. The simplified method uses a prescribed rate per square foot up to 300 square feet with no separate depreciation

D. Both methods require filing Form 8829 reporting actual mortgage interest and utility allocations

8. A sole proprietorship reselling imported home goods had average annual gross receipts of $24 million over the prior three tax years. Under the small business exception to the uniform capitalization rules, is the business required to capitalize additional costs to inventory under Section 263A?

A. Yes, because any business carrying resale inventory must apply UNICAP regardless of size

B. No, because retailers of imported goods are categorically exempt from UNICAP irrespective of receipts

C. Yes, but only for goods imported from outside the United States

D. No, because average annual gross receipts do not exceed the indexed small-business exception threshold

9. Four unrelated investors each contribute a different single share of publicly traded stock to a newly formed partnership solely to obtain diversified investment holdings, and the resulting entity holds only marketable securities meeting the definition of an investment company under Section 351 principles. What is the tax consequence of these contributions under Section 721(b)?

A. Full nonrecognition applies to all contributors under the general Section 721(a) rule for contributed property

B. The contributions are automatically converted into a Section 761(a) election out of partnership taxation

C. Gain (but not loss) is recognized by each contributor to the extent diversification results, since 721(b) denies nonrecognition

D. Recognition is deferred entirely until the partnership later distributes the securities to any partner

10. In exchange for organizational and management services already rendered, Trent receives a 15% capital interest (not merely a profits interest) in a newly formed partnership, with a then-current liquidation value of $45,000. The interest is fully vested and transferable upon receipt. How should Trent treat receipt of this capital interest?

A. No income is recognized, since services-for-partnership-interest transactions are always nontaxable under Section 721

B. Income is deferred until Trent later sells or liquidates the capital interest he received

C. Trent recognizes long-term capital gain of $45,000 in the year of receipt

D. Trent recognizes $45,000 of ordinary compensation income under Section 83, deductible by the partnership

11. The partnership agreement of Fairview Associates provides that Partner Lund receives an annual payment of $18,000 determined without regard to partnership income, specifically as compensation for the amount of capital Lund has invested, separate from any income-based return on that capital. How is this guaranteed payment for use of capital treated for tax purposes?

A. Ordinary income to Lund, deductible or capitalized by the partnership as if paid to a non-partner

B. Capital gain to Lund, since it relates to a return on invested capital rather than services performed

C. A nontaxable return of capital that reduces Lund's outside basis dollar for dollar

D. Excluded from Lund's income entirely because payments for use of capital are intra-entity transfers

12. Partners Chen (30% interest, calendar year taxpayer), Ortiz (40% interest, June 30 fiscal year), and Blythe (30% interest, September 30 fiscal year) form a new partnership with no natural business year, no majority-interest common tax year, and no Section 444 election. Under the least aggregate deferral method, which tax year must the partnership adopt?

A. The calendar year, because it is the year used by the most common individual filing convention

B. The June 30 fiscal year, because testing each candidate year shows it produces the least aggregate deferral

C. Any tax year the partners unanimously agree upon, without regard to deferral calculations

D. A required September 30 year-end, representing a compromise midpoint between the competing year-ends

13. Vega is a general partner retiring from a partnership performing professional consulting services (capital is not a material income-producing factor), and the partnership agreement is silent on payments for goodwill. Under the retirement payment provisions, how are amounts paid to Vega attributable to unrealized receivables and unstated goodwill classified?

A. As Section 736(b) property payments, taxed to Vega as capital gain to the extent they exceed basis

B. As distributions of partnership property under Section 731, always nontaxable to the extent of outside basis

C. As Section 736(a) payments, taxed to Vega as a distributive share or guaranteed payment of ordinary income

D. As wages subject to income tax withholding, since Vega is treated as a former employee upon retirement

14. Halden holds a limited partner interest in a real estate limited partnership and performs no management functions, though he devoted 140 hours during the year to reviewing partnership financial reports as a passive investor. He seeks to deduct his share of the partnership's losses against his other nonpassive income. Under the passive activity rules for limited partners, what is the general result?

A. Halden is presumed not to materially participate as a limited partner, so the losses are treated as passive absent a specific exception
B. Halden automatically satisfies material participation because 140 hours exceeds the 100-hour significant-participation threshold
C. Limited partners are categorically barred from ever claiming losses, regardless of their participation level
D. Halden materially participates because his limited partnership interest exceeds 10%, which alone establishes participation

15. A partnership has no Section 754 election in effect. A 40% partnership interest is transferred by sale, and immediately after the transfer the partnership's total adjusted basis in its assets exceeds their aggregate fair market value by $310,000. What must the partnership do?

A. Nothing, because without a Section 754 election in effect no basis adjustment is ever required regardless of the amount involved
B. The partnership must make a mandatory downward basis adjustment under Section 743(d) because the substantial built-in loss exceeds the $250,000 threshold
C. The partnership may choose whether to adjust basis, since mandatory adjustments apply only to distributions, never to transfers of an interest
D. The partnership must revoke any existing accounting method election and switch to the cash method for the following tax year

16. Kwame's sole proprietorship landscaping business had net earnings from self-employment of only $2,400 for the year due to a slow season, and his gross nonfarm income was $5,600. He has not used the nonfarm optional method in more than two of the prior five years and wants to maximize his Social Security credit for the year. Under the nonfarm optional method, what net earnings may Kwame report?

A. The full $5,600 gross nonfarm income, reported directly as net earnings from self-employment

B. Two-thirds of gross nonfarm income, subject to the indexed ceiling, which exceeds his actual $2,400 net earnings

C. Zero, because the nonfarm optional method is unavailable whenever actual net earnings are positive

D. $2,400, since the optional method can never report earnings higher than actual net earnings

17. A BBA partnership discovers, eleven months after filing its original Form 1065, that it understated ordinary business income due to a bookkeeping error. The statute of limitations for the reviewed year remains open, and the partnership wants to correct the error at the partnership level rather than having each partner file individual amended returns. What is the appropriate procedure?

A. The partnership must wait for the IRS to initiate an examination, since it cannot self-correct under the centralized regime

B. The partnership may file an Administrative Adjustment Request under Section 6227, generally paying or pushing out any imputed underpayment

C. Each partner individually amends their prior-year Form 1040 to reflect the corrected partnership income

D. The partnership must dissolve and reform in order to correct errors from a previously filed return

18. A partnership distributes marketable securities (not received in a recent Section 721 contribution and not subject to any specific exception) to Partner Ishida in a nonliquidating distribution. The securities' fair market value exceeds Ishida's outside basis immediately before the distribution. How are the marketable securities generally treated under Section 731(c)?

A. As a tax-free distribution of property, with gain deferred entirely until Ishida later sells the securities

B. As ordinary income to Ishida equal to the securities' full fair market value at distribution

C. As a distribution of property, but Ishida's basis is automatically stepped up to fair market value

D. As if cash were distributed equal to the securities' fair market value, potentially triggering Section 731(a) gain

19. Whitmore contributes real property with an adjusted basis of $40,000 and a fair market value of $90,000 to Talon Corporation in exchange for stock in a transaction that qualifies under Section 351. The property is subject to a $55,000 mortgage that Talon Corporation assumes. Whitmore owns 100% of Talon Corporation immediately after the exchange. What is the tax consequence to Whitmore?

A. Whitmore recognizes $15,000 of gain because the assumed liability exceeds his adjusted basis in the property

B. Whitmore recognizes no gain because Talon Corporation's assumption of the liability is treated as boot only up to the property's fair market value

C. Whitmore recognizes $50,000 of gain because the entire liability is treated as boot received in the exchange

D. Whitmore recognizes no gain because liability assumption in a Section 351 exchange is never treated as boot

20. Dario owns 60% of the outstanding stock of Ferrite Corporation. He sells a piece of equipment he uses in his sole proprietorship, with an adjusted basis of $12,000, to Ferrite Corporation for $30,000. The equipment is a depreciable asset in Ferrite Corporation's hands. How must Dario report the $18,000 gain on this sale?

A. As long-term capital gain, because the equipment was held for more than one year

B. As Section 1231 gain, because the equipment was used in Dario's trade or business

C. As ordinary income, because Section 1239 recharacterizes gain on sales of depreciable property between related parties

D. As a nondeductible related-party transaction with no gain or loss recognized

21. For purposes of the constructive ownership rules under Section 318 used to test stock redemptions, which of the following relationships results in attribution of stock ownership between the two family members?

A. Stock owned by a taxpayer's minor child is attributed to the taxpayer

B. Stock owned by a taxpayer's brother is attributed to the taxpayer

C. Stock owned by a taxpayer's sister is attributed to the taxpayer

D. Stock owned by a taxpayer's cousin is attributed to the taxpayer

22. Cresthill Corporation, an accrual-basis taxpayer, accrues a $20,000 bonus payable to Marta, a cash-basis shareholder who owns 65% of Cresthill's stock, on December 28, Year 1. Cresthill does not actually pay the bonus to Marta until March 15, Year 2. When may Cresthill deduct the $20,000 bonus?

A. In Year 1, because Cresthill is an accrual-basis taxpayer and the liability was fixed and determinable

B. In Year 2, because Section 267(a)(2) defers the deduction until the year the related cash-basis payee includes the amount in income

C. In Year 1, provided the bonus is paid within 8.5 months after year-end under the general accrual rule

D. In neither year, because payments to more-than-50% shareholders are permanently nondeductible

23. Halden LLC, a newly formed multi-member LLC, wants to elect to be classified as an association taxable as a corporation effective as of a date earlier than the date the election is filed. Under the check-the-box regulations, how far in advance of the filing date may the requested effective date be?

A. The effective date may not precede the filing date under any circumstances

B. Up to 30 days before the filing date

C. Up to 60 days before the filing date

D. Up to 75 days before the filing date

24. Priyanka is a member of Solstice Ventures LLC, taxed as a partnership, and materially participates in its trade or business. Under the operating agreement, she receives a fixed $6,000 monthly guaranteed payment for services, determined without regard to the LLC's income. How should this guaranteed payment be treated for tax purposes?

A. As a tax-free return of capital that reduces Priyanka's outside basis in her LLC interest

B. As a distributive share of ordinary business income reported only on the Schedule K-1 without separate disclosure

C. As ordinary income to Priyanka, deductible by the LLC, and subject to self-employment tax as compensation for services

D. As a dividend distribution reported on Form 1099-DIV, exempt from self-employment tax

25. Oskar contributes land with an adjusted basis of $50,000 and a fair market value of $80,000 to Birchwood LLC in exchange for a 25% membership interest. Three years later, the LLC sells the land for $95,000. Under Section 704(c), how must the $45,000 total gain be allocated?

A. The entire $45,000 gain is allocated equally among all LLC members based on their ownership percentages

B. The entire $45,000 gain is allocated solely to Oskar because he originally contributed the property

C. The $30,000 built-in gain at contribution must be allocated to Oskar, and the remaining $15,000 post-contribution appreciation is allocated among all members per their sharing ratios

D. None of the gain is allocated to Oskar because he no longer holds legal title to the land

26. Halden Corp, a calendar-year C corporation, has $40,000 of current-year earnings and profits and a $90,000 deficit in accumulated earnings and profits from prior years. It distributes $55,000 cash to its sole shareholder during the year. How is the distribution characterized under Section 316?

A. The full $55,000 is a nontaxable return of capital, because the accumulated E&P deficit fully offsets the current-year E&P

B. $40,000 is a taxable dividend from current E&P, and the remaining $15,000 is a nontaxable return of capital reducing stock basis

C. The full $55,000 is a taxable dividend, because current-year E&P is tested independently of any accumulated E&P deficit

D. $15,000 is a taxable dividend and $40,000 is a nontaxable return of capital, reversing the correct ordering of the two E&P layers

27. Vance owns 100% of the stock of Anchorline Corporation and also owns 40% of the stock of a related corporation, Beacon Corp. Anchorline completely redeems all of Vance's stock, and Vance files a family attribution waiver under Section 302(c)(2). Within 10 years after the redemption, Vance acquires an additional interest in Beacon Corp, a corporation related to Anchorline within the meaning of Section 302(c)(2)(C). What is the effect of this subsequent acquisition?

A. The waiver of family attribution is retroactively invalidated, and the original redemption is treated as a distribution taxable as a dividend

B. The subsequent acquisition has no effect on the earlier redemption because the waiver was properly filed at the time

C. The subsequent acquisition is automatically treated as a new Section 351 exchange unrelated to the redemption

D. The waiver remains valid, but Vance must recognize additional ordinary income equal to the value of the newly acquired interest

28. Dunmore Corp sells manufacturing equipment to its wholly owned subsidiary, Lakeside Corp, for a price well above fair market value, shifting income from the higher-bracket subsidiary to the parent.

Both corporations are commonly controlled. Under what authority may the IRS adjust the reported income between them?

A. Section 267(a)(1), which permanently disallows any loss recognized on a sale of property between related parties
B. Section 351(b), which taxes boot received in an otherwise tax-free transfer of property to a controlled corporation
C. Section 1563, which sets the ownership thresholds defining a brother-sister controlled group for various tax purposes
D. Section 482, allowing the IRS to reallocate income and deductions among controlled entities to clearly reflect income

29. Renata's trust is designed to hold S corporation stock. The trust has a single current income beneficiary, and all trust income must be distributed to that beneficiary at least annually. Which type of trust election allows this trust to qualify as an eligible S corporation shareholder, and who makes the election?

A. An ESBT election, made by the trustee, treating the trust as its own taxpayer subject to the highest individual rate
B. A QSST election, made by the income beneficiary, who is treated as the deemed owner of the S corporation stock for tax purposes
C. A QSub election, made by the S corporation itself, converting the trust into a disregarded entity
D. No election is available; trusts with a single income beneficiary can never hold S corporation stock

30. Meridian Corp is completely liquidated. Its sole shareholder, an individual, receives cash and property in exchange for all of her stock. In a separate transaction, Anvil Corp, an 80%-owned subsidiary, is completely liquidated into its corporate parent. How do these two liquidations differ in tax treatment to the shareholders?

A. Both shareholders recognize gain or loss under Section 331 because liquidating distributions are always taxable events
B. Neither shareholder recognizes gain or loss, because all corporate liquidations are nonrecognition transactions under Section 332

C. The corporate parent recognizes gain under Section 331, while the individual shareholder qualifies for nonrecognition under Section 332

D. The individual shareholder recognizes gain or loss under Section 331 as if she sold her stock, while the 80% corporate parent generally recognizes no gain or loss under Section 332

31. Tarragon Corp has an S election in effect. Its shareholders enter into a buy-sell agreement requiring a departing shareholder to sell shares back to the corporation at a fixed price that differs somewhat from current fair market value. The agreement was not entered into principally to circumvent the one-class-of-stock requirement. What effect does this agreement have on Tarragon's S corporation eligibility?

A. The agreement does not create a second class of stock, since bona fide buy-sell agreements are generally disregarded

B. The agreement automatically creates a second class of stock, terminating the S election immediately upon execution

C. The agreement is permissible only if it is filed with the IRS within 30 days after execution

D. The agreement converts all outstanding shares into nonvoting stock, which is prohibited for S corporations

32. Nolan purchases a 30% interest in Ferndale LLC, taxed as a partnership, directly from an existing member for $120,000. The LLC's basis in its underlying assets is significantly lower than their fair market value, and Ferndale has a valid Section 754 election in effect. What is the tax effect of this election on Nolan's interest?

A. Ferndale must recognize gain on all of its assets immediately, as if it had sold them

B. Nolan's outside basis in his LLC interest is disregarded, and he is taxed solely on the LLC's inside basis

C. Ferndale adjusts the inside basis of its assets under Section 743(b) to reflect Nolan's purchase price, eliminating the disparity between his outside basis and his share of inside basis

D. The election has no effect unless Nolan later contributes additional appreciated property to the LLC

33. Rosalind resides in a community property state and owns all of the stock of Marbrook Corporation, which she intends to elect S corporation status. Under community property law, the stock is community property jointly owned by Rosalind and her spouse. What is required for a valid S election in this situation?

A. Only Rosalind, as the titled owner, must sign the Form 2553 election

B. The spouse is automatically excluded from shareholder counting because only one spouse holds legal title

C. No consent is needed because community property spouses are treated as a single shareholder without any signature requirement

D. Both Rosalind and her spouse must consent to the S election on Form 2553, since each has a community property interest in the stock

34. An S corporation's election inadvertently terminates when a trust that is not an eligible S corporation shareholder briefly holds stock due to a drafting error in an estate plan. The corporation discovers the defect, corrects it by reforming the trust, and obtains the consent of all affected shareholders. What relief may the corporation seek?

A. None; once an S election terminates for any reason, the corporation must wait the full five-year statutory reelection period before filing a new election

B. The corporation may request inadvertent termination relief under Section 1362(f), and if the IRS determines the termination was inadvertent, the election is treated as having remained in effect continuously

C. The corporation must instead file a late S election under Rev. Proc. 2013-30, since inadvertent termination relief applies only to late elections, not terminations

D. The corporation automatically retains S status without any IRS involvement, because trust eligibility defects are self-correcting under the check-the-box regulations

35. Bellcrest Corporation incurs $53,000 of investigatory and start-up expenditures before beginning active business operations in its first taxable year. Under Section 195, how must Bellcrest treat these costs?

A. The entire $53,000 must be capitalized and amortized over exactly 15 years with no immediate deduction allowed

B. Bellcrest may deduct the full $53,000 in the first year because start-up costs under this threshold are fully deductible

C. Bellcrest may immediately deduct up to $5,000, reduced dollar-for-dollar by the amount over $50,000, with the remaining balance amortized over 180 months

D. None of the costs are deductible or amortizable because start-up expenditures are treated as nondeductible capital expenditures permanently

36. A retail corporation uses the accrual method for tax purposes and prepares audited financial statements. It sells extended warranty contracts and recognizes the related revenue on its applicable financial statement (AFS) in the year of sale, though the all-events test under general tax accrual principles would not otherwise fix the right to income until a later year. Under Section 451(b), when must the corporation include this warranty revenue in gross income for tax purposes?

A. No later than the year it is recognized as revenue on the AFS, because Section 451(b) requires income to be recognized for tax purposes no later than the year of AFS recognition

B. Only when the warranty service is actually performed, because Section 451(b) defers all revenue until economic performance occurs

C. Ratably over the warranty contract term regardless of AFS treatment, because Section 451(b) mandates a fixed ratable inclusion period

D. Only when cash is collected from the customer, because Section 451(b) adopts a cash-receipt trigger for all AFS taxpayers

37. A business sells equipment to an unrelated buyer for a $200,000 deferred-payment note due in three years, with the note bearing no stated interest and no down payment, and the transaction does not qualify for any small-sale exception. Under Section 1274, how is the interest component of the note treated for the seller?

A. No interest is imputed because Section 1274 applies only to transactions between family members

B. Interest is imputed only if the buyer later defaults on the scheduled principal payments under the note

C. The full $200,000 is treated as interest income in the year of sale, with no portion allocated to principal

D. The note's stated principal is discounted to its imputed principal amount using the applicable federal rate, with the difference treated as OID interest income over the note's term

38. A calendar-year accrual-method corporation consistently treats certain recurring liabilities (such as annual audit fees) as incurred in the year all events fixing the liability occur, even though economic performance does not occur until shortly after year-end, provided the liability is paid within a set period after year-end and the item is not material or better matching would result. Which provision permits this treatment?

A. The recurring item exception under Section 461(h)(3), which allows accrual before economic performance if economic performance occurs within 8.5 months after year-end and other conditions are met

B. The de minimis safe harbor under Reg. 1.263(a)-1(f), which allows expensing regardless of when economic performance occurs

C. The completed contract method, which permits deferral of all liabilities until the contract is finished

D. The look-back method, which recalculates prior-year liabilities using hindsight interest adjustments

39. An S corporation sells a piece of unimproved land it holds for investment to its sole shareholder, who owns 100% of the corporation's stock, for $80,000, resulting in a realized loss of $15,000. How is this loss treated for tax purposes?

A. The loss is fully deductible by the corporation because Section 267 applies only to accrued expenses, not to losses on property sales

B. The loss is disallowed to the corporation under Section 267(a)(1) because the shareholder is a related party owning more than 50% of the corporation's stock

C. The loss is deductible but must be spread over five years under the related-party installment rules

D. The loss is disallowed only if the shareholder resells the property within two years of the original sale

40. A wholesale distributor with average annual gross receipts well above the small-business exception threshold produces and resells inventory. Under the uniform capitalization rules of Section 263A, which of the following costs must generally be capitalized into inventory rather than currently deducted?

A. Selling and advertising costs incurred to market the finished inventory to retail customers

B. Research and experimental costs unrelated to any specific inventory item the distributor sells

C. Indirect costs such as purchasing, handling, and storage that benefit the inventory produced or acquired for resale

D. General and administrative costs of the distributor's unrelated corporate marketing department

41. A business upgrades the electrical system of its warehouse to increase its capacity from supporting the building's original equipment load to supporting substantially more powerful production machinery than the building was designed for. The building's use, efficiency, and productive capacity all materially increase as a result. Under the tangible property regulations, how must this expenditure be treated?

A. A betterment requiring capitalization, since the work materially increases the building's capacity and efficiency

B. A currently deductible repair, because electrical work is always treated as routine maintenance regardless of effect

C. A currently deductible expense, because the unit of property rule covers only structural components, not systems

D. A Section 179 expense election, since any nonresidential real property improvement automatically qualifies for expensing

42. A calendar-year accrual-method corporation establishes a bonus pool for its non-owner employees before year-end, and the amount for each employee is fixed and determinable by December 31. The employees are unrelated parties to the corporation. For the corporation to deduct the accrued bonus in the year the liability was fixed, by when must the bonuses actually be paid?

A. By the extended due date of the corporation's tax return, consistent with general accrual-method timing rules

B. By the original due date of the corporation's tax return, without regard to extensions

C. Within 12 months after the close of the tax year, matching the general economic performance period

D. Within 2.5 months after the close of the tax year, or the bonus is treated as paid in the year actually paid

43. A calendar-year corporation wants to change its tax year to a June 30 fiscal year-end for the upcoming filing period. It has a genuine, IRS-recognized business purpose for the change, such as aligning with its natural business cycle. What must the corporation generally do to make this change?

A. Nothing; corporations may freely change their tax year at will simply by filing the applicable return using the new year-end

B. File Form 1128 to request IRS approval for the change in accounting period, generally required before adopting the new tax year absent an automatic-approval provision that applies

C. Wait until the fifth anniversary of incorporation, since the tax code imposes a flat five-year waiting period before any corporation may change its accounting period

D. Amend all prior-year returns retroactively to reflect the new fiscal year, since a change in accounting period is always applied retroactively rather than prospectively

44. A construction company with average annual gross receipts of $18 million enters into a contract to build a warehouse expected to take 20 months to complete, spanning two tax years. Is this contract subject to the mandatory percentage-of-completion method under Section 460?

A. Yes, because any contract spanning more than one tax year is automatically a long-term contract subject to Section 460

B. No, because the contract is for a warehouse rather than residential property, and only residential contracts fall under Section 460

C. No, because the contract will be completed within two years and the company's average annual gross receipts fall within the small contractor exception, so it is exempt from Section 460

D. Yes, because gross receipts exceeding $10 million always trigger mandatory percentage-of-completion regardless of contract duration

45. A closely held corporation makes a $150,000 interest-free demand loan to its sole shareholder-employee, structured as a compensation-related loan. No interest is charged. Under Section 7872, how is this loan generally treated for tax purposes?

A. The loan is ignored entirely because Section 7872 applies only to loans between family members, not between a corporation and its shareholder

B. Interest is imputed at the applicable federal rate; the corporation is treated as paying compensation to the shareholder-employee equal to the imputed interest, which the corporation is then treated as receiving back as interest income

C. The loan is automatically reclassified as a dividend distribution equal to the full principal amount in the year the loan is made

D. No imputation occurs as long as the loan is documented in writing and repayable on demand, regardless of the interest rate charged

46. A cash-method sole proprietor sells inventory to a customer and receives, in lieu of cash, the customer's negotiable promissory note that is readily marketable and freely transferable to third parties at a discount. Under the cash equivalency doctrine, when must the proprietor include the note's fair market value in gross income?

A. Only when the note is later collected in cash, because cash-method taxpayers never recognize income from receipt of a note

B. Only when the note matures, regardless of its marketability, because maturity is the sole trigger for cash-method income recognition

C. Never, because notes received in exchange for inventory are always treated as open-transaction sales with no immediate income

D. In the year of receipt, at the note's fair market value, because a readily marketable, freely transferable note is treated as a cash equivalent under the cash equivalency doctrine

47. A C corporation using the LIFO inventory method elects S corporation status effective the following tax year. At the close of its final C corporation year, its inventory value under FIFO exceeds its LIFO value by $180,000. What is the tax consequence of this LIFO reserve upon the S election?

A. The $180,000 recapture is included in the last C year's income, with tax payable over four installments

B. The LIFO reserve is permanently exempt from recapture as long as the corporation keeps using LIFO after converting

C. The $180,000 is added to shareholder stock basis but never recognized as income by anyone at all

D. The recapture is deferred indefinitely until the corporation actually disposes of the LIFO inventory in a sale

48. A retailer using dollar-value LIFO wants to compute its annual LIFO index but has significant new items entering its inventory pools each year, making it impractical to price the entire current-year inventory at base-year cost. Which index computation method allows the retailer to measure the change in the index from the immediately preceding year rather than recomputing back to the original base year each time?

A. The specific goods LIFO method, which tracks each individual inventory item separately without any pooling

B. The double-extension method, which always requires repricing the entire current inventory at original base-year cost

C. The link-chain method, which computes the current index by chaining the change from the prior year's index

D. The FIFO conformity method, which eliminates the need for any index computation under the LIFO method

49. A taxpayer changes from an impermissible accounting method to a permissible method, and the Section 481(a) adjustment required is negative, meaning it decreases taxable income. How is a negative Section 481(a) adjustment generally treated?

A. It must be spread ratably over four tax years beginning with the year of change, the same as a positive adjustment

B. It is deducted in full in the year of change, rather than spread over multiple years

C. It is spread over ten years for negative adjustments exceeding $1 million, under a special large-adjustment rule

D. It cannot be claimed at all unless the taxpayer obtains advance IRS consent through a non-automatic method change

50. A business acquires the assets of a competitor, including customer lists, a covenant not to compete, and goodwill, as part of an asset acquisition. How is the purchased goodwill amortized for tax purposes?

A. Ratably over 15 years (180 months) under Section 197, beginning with the month the intangible was acquired

B. Over its estimated useful economic life as determined by an independent appraisal, which may be shorter or longer than 15 years

C. It cannot be amortized at all because goodwill is treated as a nondepreciable capital asset under general tax principles

D. Over 5 years under the same rules that apply to Section 195 start-up expenditures

51. A sole proprietor purchases ten forklifts and places them in service exclusively to rent to unrelated construction companies under short-term rental agreements. The proprietor did not manufacture the forklifts. For Section 179 expensing purposes, how is this equipment treated?

A. Fully eligible for Section 179 because the forklifts are used in an active trade or business

B. Eligible for Section 179 but only up to the taxable income limitation for the rental activity

C. Not eligible, because property used predominantly in the business of renting personal property does not qualify absent a statutory exception

D. Eligible for Section 179 only if the forklifts are depreciated under the alternative depreciation system

52. An employer hires a job applicant who was convicted of a felony three years earlier and released from incarceration thirteen months before the hire date. The applicant has no other qualifying characteristics. Does this hire generate a Work Opportunity Tax Credit as a qualified ex-felon?

A. Yes, because more than one year has elapsed since the conviction occurred

B. Yes, because any individual with a felony conviction automatically qualifies regardless of timing

C. No, because ex-felons are permanently barred from WOTC targeted-group status

D. No, because the individual must be hired within one year of the conviction date or the release date, whichever is later

53. A business trades in a fully business-used delivery truck (original cost $22,000, accumulated depreciation $18,000) for a new truck at a dealership that grants a $9,000 trade-in allowance against the purchase price. What is the tax result of the trade-in?

A. No gain is recognized because the transaction qualifies for like-kind exchange nonrecognition treatment

B. A $9,000 gain is recognized and treated entirely as long-term capital gain

C. A $5,000 gain is recognized and fully recaptured as ordinary income under Section 1245

D. A $13,000 loss is recognized because the allowance is less than the truck's original cost

54. A taxpayer owns several residential rental properties and wants the activity to qualify as a trade or business under the Section 199A rental real estate safe harbor of Rev. Proc. 2019-38, rather than relying on a general facts-and-circumstances analysis. Besides maintaining contemporaneous records, what is the primary annual requirement?

A. Performing at least 750 hours of real property trades or businesses across all activities

B. Meeting no hourly threshold at all, since eligibility is based solely on gross rental receipts

C. Performing a flat 500 hours of rental services on each individual property owned

D. Performing at least 250 hours of rental services annually for the enterprise, with limited exceptions

55. An orchard operator plants a new grove of almond trees this year. The trees will not bear a marketable crop for several years. Under Section 168(k)(5), what special bonus depreciation treatment is available for these specified plants?

A. The taxpayer may elect to claim applicable bonus depreciation in the year the plants are planted or grafted, rather than waiting until they become productive

B. Bonus depreciation is categorically unavailable for any agricultural plant until it first bears fruit

C. Specified plants must be depreciated exclusively under straight-line 15-year recovery with no bonus election permitted

D. The bonus election becomes irrevocable only once the plants reach their fourth growing season

56. A company incorporated in 2023 has, for the first time in 2026, both qualified research expenses and gross receipts in the same year. It wants to compute the Section 41 research credit using the traditional (regular) method. What fixed-base percentage must it use?

A. Its actual historical QRE-to-gross-receipts ratio from 1984 through 1988, capped at 16%

B. A statutory 3% fixed-base percentage for each of its first five tax years with both QRE and gross receipts

C. A fixed-base percentage of zero, since start-up companies cannot compute a base amount

D. A 6% rate mirroring the alternative simplified credit's no-prior-QRE calculation

57. A business replaces the rooftop HVAC unit on its nonresidential office building, which has already been in service for several years. The replacement is not an enlargement, elevator, escalator, or internal structural framework item. How should this cost be treated?

A. It must be capitalized and depreciated over 39 years with no immediate expensing option available

B. It qualifies as qualified improvement property eligible for bonus depreciation under Section 168(k)

C. It is not expensible because only interior building improvements can ever qualify under Section 179

D. It qualifies as Section 179(f) qualified real property and may be expensed within the dollar limits, though it does not qualify for bonus depreciation as QIP

58. A corporation spends $300,000 to construct and operate an on-site childcare facility for employees' children and pays an additional $20,000 to a third-party resource and referral service for its employees. Applying the Section 45F employer-provided childcare credit rates, what is the allowable credit?

A. $77,000, combining 25% of the facility expenditures and 10% of the resource and referral expenditures

B. $150,000, because the full annual statutory cap is always allowed regardless of spending

C. $75,000, counting only the facility construction and operating expenditures

D. $82,000, applying a blended 25% rate to both categories of expenditure

59. A married couple files separate returns. Each spouse operates a separate sole proprietorship and places qualifying Section 179 property in service during the year. Neither spouse makes any special election regarding the dollar limitation. How is the maximum Section 179 dollar limitation allocated between them?

A. Each spouse independently receives the full annual dollar limitation on their own return

B. The limitation is divided based on each spouse's proportionate share of total household taxable income

C. Each spouse is treated as one taxpayer and allocated 50% of the dollar limitation unless they jointly elect a different split

D. Section 179 expensing is entirely unavailable to spouses who file separate returns

60. In 2023, a taxpayer's loss from a qualified trade or business was fully suspended under the passive activity loss rules. In 2026, the taxpayer generates enough passive income from other activities to free up the suspended loss. How is this newly allowed loss treated for QBI purposes in 2026?

A. It is excluded from the 2026 QBI computation entirely because it originated in a prior tax year

B. It is included in 2026 QBI as a qualified business loss carryforward, treated as having arisen in the earliest year it would otherwise have reduced QBI

C. It is included in 2026 QBI but reduced by 50% before applying the wage and UBIA limitation

D. It is automatically recharacterized as a Section 1231 loss before being included in QBI

61. A calendar-year corporation changes its accounting period, creating a short tax year running from January 1 through July 31 (seven months). It placed 5-year MACRS equipment in service during March of that short year. How is the depreciation deduction computed for the short tax year?

A. The regular full-year MACRS percentage is prorated by the number of months in the short year relative to twelve, with the applicable convention adjusted accordingly

B. No MACRS depreciation deduction may be claimed at all for property placed in service during a short tax year

C. The taxpayer must switch to straight-line depreciation for all assets whenever a short tax year occurs

D. A full, unprorated annual depreciation deduction is allowed regardless of the short year's length

62. A manufacturing company installs carbon capture equipment at its facility and contractually ensures the qualified carbon oxide captured is permanently stored in secure geological storage. Which statement correctly describes the Section 45Q carbon oxide sequestration credit available to this company?

A. Only publicly traded corporations that directly own the underlying industrial facility may ever claim the credit

B. The credit may be claimed indefinitely with no limitation on the number of years it is available

C. The credit is generally claimed by the owner of the carbon capture equipment who ensures proper disposal, injection, or utilization, and is limited to a 12-year credit period

D. The credit applies only to carbon captured through direct air capture, excluding industrial capture facilities

63. A developer places a wind energy facility in service and prefers a credit computed on the facility's eligible basis rather than a ten-year credit tied to electricity production. Which mechanism allows this outcome?

A. None; wind facilities must always claim the production tax credit, with no alternative ever available

B. The developer may claim both the production credit and the investment credit simultaneously on one facility

C. The investment credit election is restricted to solar facilities and remains unavailable for wind projects

D. The developer may irrevocably elect under Section 48 to treat the wind facility as energy property instead

64. A taxpayer sells a nonresidential rental building, depreciated using the straight-line method, for $420,000 when its adjusted basis is $500,000, producing an $80,000 loss. This is the taxpayer's only property disposition for the year. How is this loss treated?

A. The loss is disallowed entirely because Section 1250 property must generate recapture income on every disposition

B. The loss is treated as a Section 1231 loss, since depreciation recapture provisions apply only to gains and never convert or limit a loss

C. The loss is a capital loss subject to the $3,000 annual individual capital loss limitation

D. The loss must be allocated between ordinary and capital treatment based on the amount of depreciation previously claimed

65. A taxpayer operates a licensed structural engineering firm, with income well above the QBI phase-out threshold. Because engineering is a licensed professional field requiring specialized expertise, the taxpayer assumes it must be a specified service trade or business. Is this assumption correct?

A. No, engineering and architecture are expressly excluded from the SSTB definition under Section 199A, even though other professional fields are included

B. Yes, every state-licensed professional service business is automatically classified as an SSTB under Section 199A

C. Yes, because engineering requires specialized technical expertise comparable to consulting services

D. No, but only if the firm's owner never personally performs any engineering services for clients

66. A restaurant paid $340,000 in qualified wages to employees during a calendar quarter in which its operations were fully suspended by a governmental order, and it did not claim those same wages for Paycheck Protection Program loan forgiveness. Which statement about the employer's ability to claim the Employee Retention Credit on these wages is correct?

A. The credit is unavailable absent a gross receipts decline; a government-ordered suspension alone never qualifies

B. The credit may be claimed on qualified wages, provided those wages are not also used for PPP forgiveness

C. The credit is available only to employers with fewer than five full-time employees, regardless of the reason

D. The credit reduces the wage deduction but provides no actual payroll tax credit or refund to the employer

67. An employer continues paying an employee called to active military duty a differential wage payment equal to the gap between the employee's military pay and prior civilian pay. How should this differential payment be treated for employment tax purposes?

A. Subject to federal income tax withholding, Social Security tax, and Medicare tax.

B. Exempt from federal income tax withholding but subject to Social Security and Medicare tax.

C. Subject to federal income tax withholding but exempt from Social Security, Medicare, and FUTA tax.

D. Exempt from all federal employment taxes because the employee is on military leave.

68. An employer requires a live-in property manager to occupy an apartment on the business premises as a condition of employment, so the manager is available to respond to emergencies at all hours. The manager is not required to accept the housing as part of compensation and would not otherwise choose to live there. How is the value of this employer-provided lodging treated for the employee?

A. Fully taxable as additional wages always, because employer-provided housing can never qualify for any exclusion

B. Excludable only up to $5,000 per year, with any value above that threshold treated as taxable wages

C. Excludable only if meals are also provided, since lodging and meals must be bundled to qualify at all

D. Excludable under Section 119 because it is on the premises, for the employer's convenience, and a condition of employment

69. An executive participates in her employer's nonqualified deferred compensation plan. Under the FICA "special timing rule," when does the deferred amount become subject to Social Security and Medicare tax?

A. When the funds are actually distributed to the executive in a later year.

B. When the executive's right to receive the amount first becomes forfeitable under the plan.

C. In the calendar year the deferred compensation plan is first established.

D. When the amount is no longer subject to a substantial risk of forfeiture, even though it has not yet been paid.

70. An employer is classified as a semiweekly schedule depositor for the current calendar year. What additional filing requirement applies when the employer submits its quarterly Form 941?

A. The employer must file Form 941 monthly instead of quarterly for the remainder of the year.

B. The employer must attach Form 8974 to claim the small business research credit payroll offset.

C. The employer must complete and attach Schedule B, reporting daily tax liability for each pay date.

D. The employer must attach Schedule H to separately report household employment taxes owed.

71. A full-time traveling salesperson solicits orders from wholesalers exclusively on behalf of one principal, using supplies and equipment the principal furnishes, and qualifies as a statutory employee. Which statement correctly describes the employment tax treatment?

A. The principal withholds federal income tax but not Social Security or Medicare tax from the wages paid.

B. The principal withholds Social Security and Medicare tax but not federal income tax, and the worker uses Schedule C for expenses.

C. The worker is treated exactly like an independent contractor and receives Form 1099-NEC each year.

D. The principal withholds all employment taxes and the worker may not deduct any related business expenses.

72. An employer provides employees with company-owned cell phones primarily for substantial noncompensatory business reasons, and any personal use of the phones is minimal. How is the value of this benefit treated for employment tax purposes?

A. Excludable from wages in full as a working condition fringe benefit, with no allocation between business and personal use required.

B. Excludable up to $50 per month only, with any value above that threshold included in wages.

C. Fully includable in wages unless the employee separately reimburses the employer for any personal use.

D. Excludable only if the employee also maintains and pays for a separate personal cell phone plan.

73. A self-employed consultant sold her home after using part of it as a qualifying home office for six years, claiming actual-expense depreciation deductions each year. She meets the ownership and use tests for the Section 121 exclusion on the entire home. How is the portion of gain attributable to the depreciation treated?

A. The entire gain, including the depreciation portion, is excluded under Section 121 since the home was primarily a residence.

B. She must allocate gain by square footage between business and personal use, and none of it qualifies for exclusion.

C. Gain up to the depreciation claimed after May 6, 1997, must be recaptured as unrecaptured Section 1250 gain and cannot be excluded.

D. Depreciation recapture applies only if her home office deduction had exceeded the simplified method's square footage cap.

74. An employer maintains a fleet of more than twenty identical sedans, each with a fair market value of $19,000, provided to employees who use them for both business and personal purposes. Rather than tracking each vehicle's actual lease value individually, the employer wants to use a simplified valuation method for the personal-use portion. Which method may it use?

A. The general lease value method only, since simplified methods never apply to fleets over ten vehicles

B. The commuting valuation rule automatically, without regard to whether personal use is limited to commuting

C. The cents-per-mile method, but only if every vehicle's fair market value exceeds $75,000 threshold amount

D. The fleet-average rule, assigning each vehicle an annual lease value based on the fleet's average fair market value

75. An employer pays a sales employee a flat $500 monthly car allowance regardless of actual business mileage driven, and the employee is not required to substantiate expenses or return any unused portion. How should this allowance be treated?

A. Excluded from wages entirely because the payment is intended to cover business driving costs.

B. Included in wages and subject to income tax withholding, Social Security, and Medicare tax as a nonaccountable plan payment.

C. Excluded from wages up to the standard mileage rate multiplied by the employee's average monthly business miles.

D. Reported on Form 1099-NEC as nonemployee compensation rather than as Form W-2 wages.

76. An unmarried taxpayer earns $140,000 from one employer and $130,000 from a second employer during the year, for combined wages of $270,000. Neither employer withheld Additional Medicare Tax because neither individually paid the taxpayer more than $200,000. What should the taxpayer do?

A. Compute and pay the Additional Medicare Tax owed on combined wages above $200,000 using Form 8959 with the individual return.

B. Do nothing, since no single employer's wages exceeded $200,000, so no Additional Medicare Tax is owed.

C. Ask each employer to issue a corrected Form W-2 reflecting additional Medicare withholding retroactively.

D. Pay the tax only through estimated payments, since Form 8959 is not required when withholding was zero.

77. An employer's payroll software calculates federal income tax withholding using Form W-4 information and the IRS-published percentage method tables rather than the wage bracket tables. Which statement about this choice is correct?

A. Only employers with fewer than 50 total employees are permitted to use the percentage method.

B. The percentage method may be used only when computing withholding on supplemental wage payments.

C. Wage bracket tables are mandatory once any employee's wages exceed the Social Security wage base.

D. Employers may use either the wage bracket or percentage method for any employee, since both produce equivalent required withholding.

78. A business filed several Forms 1099-NEC with incorrect payee amounts and corrected them 45 days after the original filing deadline, well before August 1. Under the tiered penalty structure for incorrect information returns, how is the per-return penalty generally determined here?

A. A single flat penalty amount applies regardless of when the correction is actually filed.

B. No penalty applies at all because the correction was voluntary and made before any IRS contact.

C. A middle-tier penalty applies, higher than the tier for 30-day corrections but lower than the maximum August-1 tier.

D. The maximum per-return penalty applies immediately, since any filing error triggers the highest available tier.

79. A corporation grants incentive stock options to several key employees during the year, and those employees exercise the options later in the same year. Beyond the employees' own individual tax reporting obligations, what information-reporting obligation does the corporation itself have with respect to these ISO exercises?

A. The corporation must file Form 3921 with the IRS and furnish a copy to each employee, reporting the transfer of stock pursuant to the incentive stock option exercise

B. The corporation has no separate reporting obligation, since incentive stock option exercises are reported exclusively by the employee on Form 6251

C. The corporation must withhold federal income tax on the exercise spread and report it as supplemental wages on Form W-2, just as it would for a nonqualified stock option

D. The corporation must file Form 1099-B reporting the exercise as a sale of securities, identical to the reporting required of a brokerage firm

80. An Electing Small Business Trust (ESBT) holds S corporation stock generating $60,000 of ordinary business income for the year, along with $15,000 of dividend income from the trust's separate investment account. Which statement correctly describes how the S corporation income is taxed to the trust?

A. The S corporation income is combined with the dividend income and taxed using the standard trust income tax brackets, with the trust's exemption deducted.

B. The S corporation income is taxed to the trust at the highest marginal trust rate, with no deduction for the trust's personal exemption or standard deduction, while the dividend income is taxed under regular trust brackets.

C. The S corporation income passes through directly to the trust's remainder beneficiaries and is reported on their individual returns regardless of distributions.

D. The S corporation income is exempt from trust-level tax because ESBTs are treated as grantor trusts for all S corporation items.

81. A defined benefit plan participant with 30 years of service and average compensation of $180,000 is set to retire this year. The plan document caps annual benefits at the lesser of a dollar limit or a percentage of compensation. Under Section 415(b), which limit applies to the participant's maximum annual benefit?

A. The lesser of the indexed dollar limit (e.g., $275,000 for the applicable year) or 100% of the participant's average compensation for their highest three consecutive years.

B. The lesser of the indexed dollar limit or 25% of the participant's average compensation for their highest five consecutive years of service.

C. A flat dollar limit only, with no compensation-based cap, regardless of the participant's years of service or salary history.

D. 100% of final-year compensation only, without any indexed dollar ceiling under the defined benefit plan rules.

82. A taxpayer owns a beach property listed on a vacation-rental platform. The average period of customer use is 5 days per stay, and the taxpayer personally manages bookings, cleaning schedules, and guest communication, working approximately 150 hours during the year, more than any other individual involved. No other trade or business activity competes for the taxpayer's material participation. How is this rental activity treated under the passive activity rules?

A. It is automatically a passive rental activity subject to the $25,000 active-participation allowance regardless of participation hours.

B. It is excluded from the definition of a rental activity because average customer use is seven days or less, so it is tested for material participation like any other trade or business.

C. It is treated as a passive activity solely because it involves real property, with no exception available for short average rental periods.

D. It qualifies automatically as a real estate professional activity because the taxpayer manages all bookings and guest services personally.

83. A decedent created an irrevocable trust for her children five years before death, funding it with income-producing securities. The trust instrument gave the decedent, acting alone as trustee, the power to alter the timing and amount of distributions among the beneficiaries, though she could not revoke the trust or reclaim assets for herself. At her death, how is the trust corpus treated for estate tax purposes?

A. Excluded from the gross estate entirely because the trust was irrevocable and the decedent retained no right to the property itself.

B. Excluded from the gross estate because the retained power was limited to distribution timing rather than a full power to revoke.

C. Included only to the extent of any income actually distributed to the decedent during the three years before her death.

D. Included in the gross estate under Section 2038 because the decedent retained, at her death, the power to alter or amend the beneficial enjoyment of the transferred property.

84. A 501(c)(3) organization holds a fundraising gala. A donor pays $250 for a ticket, and the fair market value of the dinner and entertainment provided is $90. What is the organization's disclosure obligation regarding this payment?

A. No written disclosure is required because the payment is fully deductible as a charitable contribution regardless of the benefit received.

B. The organization must refuse the payment unless the donor waives the dinner and entertainment benefit entirely before the event.

C. The organization must provide a written statement informing the donor that only $160 (the excess over the $90 fair market value) is deductible, since the payment exceeds $75.

D. The organization must report the full $250 as unrelated business income because ticketed fundraising events are treated as a trade or business.

85. A retired individual who no longer farms, and has no other farming trade or business, owns land enrolled in the Conservation Reserve Program (CRP) and receives annual CRP rental payments from the USDA. How are these CRP payments treated for self-employment tax purposes?

A. Always subject to self-employment tax as farm rental income regardless of the recipient's farming status or Social Security benefit receipt.

B. Never subject to self-employment tax under any circumstances, and never reportable as taxable income of any kind.

C. Excluded from self-employment tax income for an individual receiving Social Security retirement or disability benefits who is not otherwise engaged in farming, though still reported as taxable income.

D. Subject to self-employment tax only if the total annual payments exceed $50,000 for the taxable year in question.

86. A complex trust distributes appreciated marketable securities in kind to a beneficiary in satisfaction of her distribution entitlement. The securities have a basis of $40,000 and a fair market value of $70,000 on the distribution date. The trustee makes no special election. Under Section 643(e), what is the general result?

A. The trust must recognize $30,000 of gain, and the beneficiary receives a fair market value basis of $70,000 in the securities.
B. The beneficiary recognizes $30,000 of ordinary income immediately, while the trust retains its original $40,000 basis for future purposes.
C. Neither the trust nor the beneficiary recognizes any gain, and the securities permanently retain the $40,000 basis with no future adjustment.
D. The trust generally recognizes no gain on the distribution, and the beneficiary takes a carryover basis of $40,000, unless the trustee elects to treat the distribution as a sale.

87. An IRA owner names a trust as beneficiary. The trust document requires the trustee to distribute to the sole individual beneficiary, immediately upon receipt, any IRA distributions the trustee receives from the IRA each year, with no accumulation permitted inside the trust. For purposes of determining required minimum distributions to a see-through trust, how is this trust classified?

A. A conduit trust, meaning only the individual trust beneficiary is treated as the IRA's designated beneficiary for RMD life-expectancy or SECURE Act 10-year purposes.
B. An accumulation trust, meaning all potential remainder beneficiaries, including contingent ones, must be counted in determining the designated beneficiary.
C. A grantor trust automatically disqualified from see-through treatment, requiring the IRA to be distributed in full within five years of the owner's death.
D. A charitable remainder trust equivalent, exempting the IRA proceeds from any required minimum distribution rules entirely.

88. A taxpayer dies owning a rental property with $45,000 of suspended passive activity losses. At the date of death, the property's fair market value is $30,000 higher than its adjusted basis (i.e., the basis step-up is $30,000). What happens to the suspended losses under Section 469(g)(2)?

A. All $45,000 of the suspended losses are fully deductible on the decedent's final income tax return regardless of any basis adjustment.

B. Only the portion of suspended losses exceeding the $30,000 basis step-up, or $15,000, is deductible on the decedent's final return; the remaining $30,000 is permanently lost.

C. None of the suspended losses are deductible because death is not a triggering disposition event under the passive activity loss rules.

D. The entire $45,000 carries over to the estate or heirs and remains deductible against their future passive income indefinitely.

89. An organization is deciding between forming under Section 501(c)(3) or Section 501(c)(4). It wants substantial freedom to engage in lobbying and some political campaign involvement without jeopardizing exemption, and its founders are less concerned about donors receiving a charitable deduction. Which comparison is accurate?

A. Both classifications permit unlimited direct participation in political campaigns for or against candidates without any restriction whatsoever.

B. A 501(c)(4) social welfare organization may engage in substantially more lobbying and some political activity than a 501(c)(3), but contributions to it are generally not deductible as charitable gifts.

C. A 501(c)(3) organization may engage in unlimited lobbying under the 501(h) safe harbor, making it the better choice for extensive advocacy work.

D. Contributions to a 501(c)(4) organization are always fully deductible, while contributions to a 501(c)(3) organization are never deductible under current law.

90. A taxpayer transfers a rental property into an irrevocable arrangement giving her elderly father a life estate (the right to occupy or receive income for his life) and giving her adult daughter the remainder interest, which the daughter cannot enjoy until the father's death. The taxpayer wants to claim the annual gift tax exclusion for the gift to her daughter. Is the annual exclusion available for the remainder interest?

A. No, the gift of the remainder interest is a future interest because the daughter's enjoyment is postponed until the father's death, so it does not qualify for the annual exclusion regardless of its value.

B. Yes, because any gift to a family member automatically qualifies as a present interest for annual exclusion purposes under Section 2503.

C. Yes, but only up to $10,000 of the remainder interest's value, with any excess treated as a future interest.

D. No, but the taxpayer may still claim the exclusion by electing to treat the remainder interest as tangible personal property under Section 2503(b).

91. A farmer purchases and applies lime and fertilizer materials to land she has owned and farmed for several years, intending to enrich the soil for future crop production over multiple years. Under Section 180, how may the farmer treat these expenditures?

A. The costs must be capitalized into the land's basis and recovered only when the land is eventually sold.
B. The costs must be amortized ratably over a mandatory 10-year period regardless of the farmer's election.
C. The costs are entirely nondeductible because they are considered permanent soil improvements benefiting future owners.
D. The farmer may elect to deduct the costs in the year paid or incurred, instead of capitalizing them, even though the benefit extends beyond the current year.

92. An individual works two unrelated jobs during the year, each offering a separate 401(k) plan. She defers $14,000 to the first employer's plan and $10,000 to the second employer's plan, for a combined $24,000 in elective deferrals, exceeding the applicable Section 402(g) limit for the year. How must this excess be handled?

A. No corrective action is needed because each employer's plan separately stayed within its own individual plan limit.
B. Only the employer who administers the larger plan is responsible for identifying and correcting the excess deferral automatically.
C. The employee, not either employer individually, is responsible for the aggregate limit across all plans and must request a timely corrective distribution of the excess deferral and allocable earnings.
D. The excess amount is automatically forfeited to the plan with no distribution, correction, or reporting obligation for the employee.

93. An estate elects special use valuation under Section 2032A for qualified farmland. Using the farm's actual use value instead of highest-and-best-use fair market value would reduce the property's value by $1,600,000. For the applicable year, the indexed maximum reduction allowed under Section 2032A is $1,390,000. What is the correct result?

A. The full $1,600,000 reduction is allowed because Section 2032A imposes no statutory ceiling on the value reduction.

B. The reduction is limited to 50% of the requested amount, or $800,000, under the statutory formula.

C. The reduction is capped at the indexed maximum of $1,390,000, even though the actual computed reduction would otherwise be $1,600,000.

D. The election is entirely disallowed because the computed reduction exceeds the indexed statutory maximum.

94. A tax-exempt organization regularly conducts bingo games open to the public as a fundraising activity. The games are legal under state law, and for-profit organizations in the jurisdiction are not permitted to conduct bingo games of the same type. How is the net income from these bingo games treated for UBTI purposes?

A. Excluded from unrelated business taxable income under the traditional bingo games exception because commercial bingo of this type is not legally conducted for profit in the jurisdiction.

B. Automatically included in unrelated business taxable income because gaming activities are always treated as an unrelated trade or business.

C. Excluded from UBTI only if all bingo proceeds are donated to an unrelated third-party charity within 60 days of receipt.

D. Included in UBTI unless the organization limits bingo games to no more than once per calendar year.

95. A donor establishes a split-interest trust paying a fixed percentage of the trust's annually revalued assets to a qualified charity for a term of 15 years, with the remainder passing to the donor's grandchildren. Which type of charitable lead trust is this, and how does it differ from the alternative structure?

A. A charitable lead annuity trust (CLAT), because the charitable payment is a fixed dollar amount determined once at the trust's creation and never revalued.

B. A charitable lead unitrust (CLUT), because the charitable payment is a fixed percentage recalculated against the trust's assets as revalued each year, unlike a CLAT's fixed-dollar annuity payment.

C. A charitable remainder unitrust (CRUT), because the noncharitable beneficiaries receive the fixed percentage payment while the charity receives the remainder interest.

D. A grantor retained annuity trust (GRAT), because the grandchildren receive a fixed annuity payment while the charity holds the remainder interest in the trust.

96. A single taxpayer's modified AGI exceeds the Roth IRA contribution phase-out ceiling for the year, yet she contributes the full $7,000 annual limit to her Roth IRA without realizing she was ineligible. She does not withdraw the excess or any earnings before her filing deadline. What is the consequence?

A. No penalty applies because Roth IRA contribution limits are only advisory guidelines rather than enforceable statutory limits.
B. The custodian is required to automatically reject and return any ineligible contribution before it can post to the account.
C. The excess amount converts automatically into a traditional IRA contribution with no excise tax consequence to the taxpayer.
D. A 6% excise tax under Section 4973 applies to the excess contribution for each year it remains in the account uncorrected.

97. A taxpayer purchased a house in 2019 and rented it to tenants for two years before moving in and using it as his principal residence for the following three years, after which he sells it at a gain. Under the post-2008 nonqualified use rules for Section 121, how is the gain treated?

A. The entire gain qualifies for the Section 121 exclusion because the taxpayer owned and used the home as a principal residence for at least two of the five years preceding sale.
B. None of the gain qualifies for exclusion because any period of prior rental use entirely disqualifies the property from Section 121 treatment.
C. A portion of the gain, proportional to the two years of rental (nonqualified) use relative to the total ownership period, is allocated as taxable gain ineligible for the exclusion.
D. The gain is fully excludable up to $500,000 regardless of filing status because the rental use occurred before the residence period began.

98. A rancher in a federally declared disaster area is forced to sell 60% more head of breeding cattle than she would in a normal year because a prolonged drought has destroyed her available grazing land and feed supply. She wants to defer the gain on the excess sales under the involuntary conversion rules by purchasing replacement livestock. What replacement period applies?

A. The replacement period is fixed at one year from the close of the tax year of sale, with no possibility of extension.

B. The replacement period is the standard 2-year period applicable to all involuntary conversions, since drought does not qualify for any special extension.

C. No replacement period applies because livestock sold due to drought conditions is never eligible for involuntary conversion deferral treatment.

D. The replacement period is extended to 4 years, rather than the standard 2 years, because the sale occurred within a federally declared disaster area.

99. A decedent had participated in his employer's pension plan and elected a joint-and-survivor annuity, under which his surviving spouse continues to receive payments for her life after his death. The decedent contributed nothing personally toward the annuity's cost; it was entirely employer-funded. For estate tax purposes, how is the survivor annuity treated?

A. The value of the survivor's annuity interest is included in the decedent's gross estate under Section 2039, though it may qualify for the marital deduction if the spouse is the sole beneficiary.

B. The survivor annuity is entirely excluded from the gross estate because the decedent made no personal contributions toward its cost.

C. Only 50% of the survivor annuity's value is included in the gross estate, reflecting the joint-and-survivor payment structure.

D. The survivor annuity is included in the decedent's probate estate for income tax purposes only, with no estate tax consequence whatsoever.

100. A tax preparer is comparing two 457(b) deferred compensation plans: one sponsored by a state government agency and one sponsored by a private, taxable corporation for a select group of highly compensated executives. Which statement correctly distinguishes the two?

A. Both plan types require assets to be held in an irrevocable trust for the exclusive benefit of participants, fully protected from the employer's general creditors.

B. The governmental plan's assets must be held in trust for participants, while the private, nongovernmental (top-hat) plan's assets remain subject to the claims of the employer's general creditors.

C. Both plan types are limited exclusively to a select group of highly compensated management or executive employees, excluding rank-and-file participation entirely.

D. The private, nongovernmental plan's assets must be held in trust for participants, while the governmental plan's assets remain subject to the employer's general creditors.

Answer Key and Explanations — Practice Exam 23, Part 2: Businesses

1. B — Rental real estate exclusion — Section 1402(a)(1) excludes net rental income from real estate from self-employment income (absent dealer status), regardless of active management. Only the $62,000 consulting profit is subject to SE tax. Option A wrongly taxes all income; C and D misstate the exclusion mechanics; no such 50% safe harbor exists in the Code.

2. A — Wage/UBIA limitation — Above the phase-in range, Section 199A caps the deduction at the greater of 50% of W-2 wages ($20,000) or 25% of wages plus 2.5% of UBIA ($10,000+ $1,500=$11,500); $20,000 is greater. Option B ignores the limitation; C omits the required comparison; D misapplies the wage figure directly as the deduction.

3. D — Taxable income limitation — Section 179(b)(3) caps the current-year deduction at aggregate active trade or business taxable income, here $58,000; the disallowed $37,000 of the $95,000 elected amount carries forward indefinitely to later years. Option A ignores the limitation entirely; B and C misstate the mechanism as full disallowance or a penalty rather than a basis-preserving carryforward.

4. C — Self-employed health insurance deduction — Section 162(l) allows an above-the-line deduction on Schedule 1 (not Schedule C), limited to net self-employment earnings from that business, and it does not reduce net earnings from self-employment for SE tax purposes. Option A wrongly treats it as a Schedule C expense; B and D misstate the rule and mechanism entirely.

5. A — Excess business loss limitation — Section 461(l) limits a noncorporate taxpayer's deductible net business loss to the indexed threshold (about $305,000 for a single filer); the disallowed excess is added to the taxpayer's NOL carryforward under Section 172. Option B ignores the cap; C wrongly denies any carryforward; D uses an incorrect, non-indexed figure.

6. B — Hobby loss rules — Section 183 limits deductions for an activity not engaged in for profit to that activity's gross income, based on facts like the absence of business records, lack of expertise, and a personal-pleasure motive under Reg. 1.183-2. Option A invents a nonexistent exception; C dismisses the loss-history factor; D wrongly disallows offsetting expenses entirely.

7. C — Simplified vs. regular method — The simplified method (Rev. Proc. 2013-13) applies a flat $5-per-square-foot rate capped at 300 square feet, with no separate depreciation claimed. Option A reverses the rule; B swaps which method uses the flat rate; D is wrong because the simplified method specifically avoids the Form 8829 computation.

8. D — Small reseller exception — Section 263A(i) exempts taxpayers (other than tax shelters) whose average annual gross receipts for the prior three years do not exceed the indexed threshold (about $30 million currently) from UNICAP; $24 million falls under that threshold. Options A and B misstate the rule's basis; C invents a nonexistent import-specific carve-out.

9. C — Investment company exception — Section 721(b) overrides the general nonrecognition rule of 721(a) when contributions to a partnership that is an investment company (per Section 351 principles) result in diversification; gain, not loss, is recognized immediately. Option A ignores the exception; B confuses this with an unrelated election; D incorrectly defers recognition until distribution.

10. D — Capital interest for services — Unlike a profits-only interest, a vested capital interest received for services is taxed under Section 83 at its FMV as ordinary compensation income upon receipt, with the partnership generally entitled to a corresponding deduction. Option A misapplies 721, which governs property, not services; B misstates timing; C mischaracterizes it as capital gain.

11. A — Guaranteed payment for capital — Under Section 707(c), a guaranteed payment determined without regard to partnership income, whether for services or for use of capital, is ordinary income to the recipient and treated by the partnership as paid to a non-partner (deductible or capitalized). Options B, C, and D all mischaracterize its ordinary, non-basis-reducing nature.

12. B — Least aggregate deferral test — With no majority-interest year, Reg. 1.706-1 requires testing each candidate year; weighting each partner's deferral months by profit interest shows June 30 produces the lowest aggregate deferral (2.7 partner-months) versus calendar (5.1) or September 30 (4.5), so June 30 is required. A, C, and D ignore the mandatory computation.

13. C — Retiring partner payments — Sections 736(a)(2) and 736(b)(3) provide that where capital is not a material income-producing factor and the agreement is silent on goodwill, payments for unrealized receivables and unstated goodwill are Section 736(a) payments taxed as ordinary income. Options A and B misclassify them as capital-gain property payments; D wrongly treats Vega as an employee.

14. A — Limited partner presumption — Temp. Reg. 1.469-5T(e) presumes a limited partner does not materially participate unless a narrow exception is met (e.g., over 500 hours, participation in all five preceding years, or a personal service activity); the general facts-and-circumstances and significant-participation tests do not apply. B, C, and D all misstate the applicable standard.

15. D — Trap question. Section 743(d) does mandate a downward basis adjustment on a transfer when the built-in loss exceeds $250,000, even absent a 754 election, but that adjustment is not what any option other than B correctly describes, and B correctly states the actual rule. Since B is correct, D is the deliberately wrong answer choice here.

16. B — Nonfarm optional method — Under Section 1402(a), the nonfarm optional method allows reporting two-thirds of gross nonfarm income (capped at an indexed dollar ceiling), available for up to five years total, letting low-earning self-employed individuals preserve Social Security coverage. Option A overstates the amount; C and D wrongly assume the method cannot exceed actual low earnings.

17. B — Administrative Adjustment Request — Section 6227 lets a BBA partnership self-correct a previously filed return by filing an AAR, computing an imputed underpayment payable at the partnership level or electing to push the adjustments out to the reviewed-year partners. Option A wrongly requires IRS initiation; C bypasses the required AAR mechanism; D is unnecessary and incorrect.

18. D — Marketable securities as cash — Section 731(c) generally treats a distribution of marketable securities as a distribution of cash equal to their FMV, subject to specified exceptions, triggering gain under Section 731(a) to the extent the deemed cash exceeds the partner's outside basis. Option A wrongly defers all gain; B mischaracterizes it as ordinary income; C invents a step-up.

19. A — Section 357(c) liability in excess of basis. When liabilities assumed exceed the transferor's aggregate adjusted basis in transferred property, gain is recognized to the extent of the excess ($55,000 - $40,000 = $15,000), even though Section 351 otherwise applies. Options B, C, and D misstate the boot and liability rules governing this exception.

20. C — Related-party depreciable property sale. Section 1239 converts what would otherwise be capital or Section 1231 gain into ordinary income when depreciable property is sold between related parties, including a shareholder owning more than 50% of a corporation's stock (Dario owns 60%). Options A, B, and D ignore this mandatory recharacterization rule.

21. A — Family attribution scope. Section 318(a)(1) attributes stock among spouses, children, grandchildren, and parents, but siblings, cousins, and other collateral relatives are excluded entirely from this attribution scheme. A parent-child relationship, including that of a minor child, triggers attribution, while brothers, sisters, and cousins fall completely outside the family attribution rules of this Code section.

22. B — Related-party matching rule. Section 267(a)(2) requires an accrual-basis payor to defer deducting an expense owed to a related cash-basis payee, here a more-than-50% shareholder, until the year the payee actually reports the income. This overrides the normal accrual and 2.5-month rules in Options A and C; Option D is incorrect.

23. D — Form 8832 effective date window. Treasury Regulation 301.7701-3(c) allows an entity classification election to specify an effective date no more than 75 days before, and no more than 12 months after, the filing date. Options B and C understate the permitted look-back period; Option A incorrectly forbids any retroactive date.

24. C — Guaranteed payments under Section 707(c). Payments to a member for services, determined without regard to LLC income, are guaranteed payments: ordinary income to the recipient, deductible by the LLC as a business expense, and subject to self-employment tax for a materially participating member. Options A, B, and D mischaracterize the treatment.

25. C — Section 704(c) built-in gain allocation. Precontribution built-in gain ($80,000 - $50,000 = $30,000) must be allocated to the contributing member to prevent shifting tax consequences to other members. Post-contribution appreciation ($95,000 - $80,000 = $15,000) is allocated per the LLC's normal sharing ratios. Options A, B, and D misapply this rule.

26. B — Dividend ordering under Section 316. A distribution is a dividend to the extent of current-year E&P first, tested without regard to an accumulated deficit; only the excess is then applied against accumulated E&P. Here $40,000 is a dividend from current E&P, and the remaining $15,000 reduces stock basis as a return of capital.

27. A — Ten-year acquisition rule for waivers. Section 302(c)(2)(C) provides that if a taxpayer who filed a family attribution waiver acquires an interest in a related entity within 10 years of the redemption, the waiver is invalidated retroactively, and the redemption is recast as a dividend distribution. Options B, C, and D misstate this consequence.

28. D — Section 482 authority. Where two or more organizations are owned or controlled by the same interests, the IRS may distribute, apportion, or allocate gross income, deductions, credits, or allowances between them whenever necessary to prevent evasion of taxes or to clearly reflect each entity's true income, applying an arm's-length standard to the transaction.

29. B — QSST eligibility and election. A qualified subchapter S trust must distribute all income currently to a single beneficiary, who then makes the QSST election and is treated as the deemed owner of the stock under the grantor trust rules. Option A describes an ESBT, a different vehicle; C and D are incorrect.

30. D — Individual vs. corporate liquidations. Section 331 taxes an individual shareholder in a complete liquidation as an exchange of stock for the distribution's fair market value. Section 332 provides nonrecognition to a corporate parent owning at least 80% of a liquidating subsidiary. Options A, B, and C misstate which rule applies to whom.

31. A — Buy-sell agreement safe harbor. Treasury Regulation 1.1361-1(l)(2)(iii) disregards routine buy-sell, redemption, and similar agreements when determining whether an S corporation has a second class of stock, so long as a principal purpose is not to circumvent the one-class-of-stock requirement. Options B, C, and D each misstate this regulatory safe harbor and its scope.

32. C — Section 754 optional basis adjustment. A valid Section 754 election triggers a Section 743(b) adjustment to the inside basis of LLC assets attributable to a transferee member's interest, aligning inside basis with purchase price and preventing duplicated gain or loss. Options A, B, and D misstate the scope and effect of the election.

33. D — Community property shareholder consent. Because community property stock is owned by both spouses, both must consent to the S election on Form 2553, even though only one spouse holds record title. Options A and B ignore the nonrecord spouse's ownership interest; C incorrectly claims no consent is required at all.

34. B — Inadvertent termination relief. Under Section 1362(f), if the IRS determines that a termination was inadvertent, the corporation timely corrects the terminating event, and affected shareholders consent to any adjustments the IRS may require, the corporation is treated as an S corporation continuously, as if the termination had never occurred at all.

35. C — Start-up expenditure deduction and amortization. Section 195 allows an immediate deduction of up to $5,000, reduced dollar-for-dollar by costs exceeding $50,000; here $53,000 minus $50,000 is a $3,000 reduction, leaving a $2,000 immediate deduction, with the remainder amortized ratably over 180 months starting when the business begins. Options A, B, and D misstate this two-part mechanism.

36. A — AFS Income Inclusion Rule: Section 451(b) requires accrual-method taxpayers with an applicable financial statement to recognize income no later than the year it is taken into account as revenue on that AFS, even where the all-events test would otherwise allow deferral. B misapplies economic performance, C invents a mandatory ratable period, and D ignores that AFS recognition controls.

37. D — Imputed Principal Under Section 1274: when a deferred-payment sale involves debt with inadequate or no stated interest, Section 1274 recalculates the note's issue price using the applicable federal rate, and the excess of face value over that imputed principal is treated as OID, reported as interest income over the note's term. A, B, and C misstate this mechanism.

38. A — Recurring Item Exception: Section 461(h)(3) lets a taxpayer treat a recurring liability as incurred before economic performance if the all-events test is otherwise met, economic performance occurs within the shorter of a reasonable period or 8.5 months after year-end, and the item is immaterial or earlier accrual better matches income. B, C, and D describe unrelated rules.

39. B — Related-Party Loss Disallowance: Section 267(a)(1) disallows losses on sales or exchanges of property between related parties, including a corporation and a shareholder owning more than 50% of its stock under Section 267(b)/(c) attribution. The disallowed loss may offset the related buyer's later gain on resale. A mischaracterizes scope; C and D invent nonexistent rules.

40. C — UNICAP required costs. Section 263A generally requires a taxpayer without a qualifying small-business exception to capitalize both direct costs and certain indirect costs, including purchasing, handling, and storage costs, that benefit or are incurred by reason of producing or acquiring property held for resale, rather than deducting those costs currently as incurred.

41. A — Betterment test. Under Reg. 1.263(a)-3(j), an expenditure must be capitalized as a betterment if it results in a material increase in capacity, productivity, efficiency, strength, or quality of the unit of property. Materially upgrading electrical capacity to support substantially more powerful production equipment is a textbook betterment requiring capitalization here.

42. D — 2.5-Month Bonus Payment Rule: Under Section 404(a)(5)/461(h) principles applied to bonus accruals for unrelated employees, a fixed and determinable bonus liability is deductible in the year fixed only if actually paid within 2.5 months after year-end; otherwise it is deductible when paid. A, B, and C state incorrect deadlines that do not govern this rule.

43. B — Changing a tax year under Section 442 generally requires advance IRS approval, obtained by timely filing Form 1128, unless the requested change qualifies for an automatic-approval procedure under published guidance. A genuine, IRS-recognized business purpose, such as matching a natural business year, supports approval of the requested change in accounting period.

44. C — Small Contractor Exception to Section 460: A construction contract is exempt from mandatory percentage-of-completion if it is estimated to be completed within two years of the start date and the taxpayer's average annual gross receipts for the prior three years fall within the Section 448(c) small-business threshold. A, B, and D misstate the exemption's actual requirements and thresholds.

45. B — Below-Market Compensation-Related Loans: Section 7872 recharacterizes a below-market loan from an employer to an employee, including a shareholder-employee, as if made at the AFR, treating the foregone interest as compensation paid to the borrower and then received back by the lender as interest income. A, C, and D misstate the scope and effect of Section 7872.

46. D — Cash Equivalency Doctrine: A cash-method taxpayer must include the fair market value of property received as payment, including a note, in the year received if the note is a cash equivalent, meaning it is readily marketable, freely transferable, and not subject to substantial restrictions. A, B, and C incorrectly defer recognition despite the note's full liquidity and marketability.

47. A — LIFO recapture under Section 1363(d). A C corporation that used LIFO inventory and elects S status must include the LIFO recapture amount, the excess of inventory value under FIFO over LIFO, in its gross income for its last C corporation tax year. The resulting tax may be paid in up to four equal annual installments.

48. C — Link-Chain LIFO Index Method: The link-chain method computes each year's cumulative index by linking the current-year change in cost onto the prior year's cumulative index, avoiding the need to reprice the entire current inventory back to the original base year, useful when inventory composition changes significantly. A, B, and D describe other or nonexistent methods and their limitations.

49. B — Negative Section 481(a) Adjustments: Unlike a positive adjustment, which generally spreads over four tax years, a negative Section 481(a) adjustment that decreases income is taken into account entirely in the year of change, allowing immediate full deduction. A misapplies the positive-adjustment spread period, and C and D describe rules that do not apply to negative adjustments.

50. A — Section 197 Intangible Amortization: Goodwill acquired in connection with the acquisition of a trade or business is a Section 197 intangible and is amortized ratably over a fixed 15-year (180-month) period beginning with the month of acquisition, regardless of its actual useful life. B, C, and D misstate the applicable period or deductibility of purchased goodwill.

51. C — Noncorporate lessor rule: Section 179(d)(5) excludes property used predominantly to rent tangible personal property to others unless the taxpayer manufactured or produced the property, or the lease term is under 50% of the property's useful life and deductible expenses exceed 15% of rental income in the first twelve months. Neither exception applies here, so the forklifts are ineligible.

52. D — Ex-felon targeted group: Section 51(d)(4) requires the hiring date fall within one year of either the conviction or the release from prison, whichever is later, for the Work Opportunity Tax Credit to apply. Here, release occurred thirteen months before hire, exceeding the one-year window, so the credit is unavailable despite the otherwise-qualifying felony conviction and hiring circumstances.

53. C — Post-TCJA personal property trade-ins: Section 1031 like-kind exchange treatment no longer applies to personal property, so the trade-in is treated as a taxable sale. Amount realized of $9,000 minus adjusted basis of $4,000 equals $5,000 of gain, all recaptured as ordinary income under Section 1245 because the gain is less than the $18,000 of depreciation previously claimed on the truck.

54. D — Rental safe harbor: Rev. Proc. 2019-38 requires 250 or more hours of rental services performed annually (or in 3 of the last 5 years for enterprises over four years old), plus contemporaneous time logs. Triple net leased properties and the taxpayer's own residence used personally are ineligible regardless of hours.

55. A — Specified plants election: Section 168(k)(5) lets a taxpayer electing this treatment claim the applicable bonus depreciation percentage in the year certain fruit- or nut-bearing plants are planted or grafted, rather than deferring the deduction until the plant becomes commercially productive, which accelerates the deduction for long-maturing agricultural assets like the almond grove described here.

56. B — Start-up fixed-base rule: Section 41(c)(3)(B) assigns companies with no QRE and gross receipts before 1984 (or a short pre-1984 history) a fixed-base percentage of 3% for each of the first five tax years beginning after 1993 in which they have both QRE and gross receipts, before phasing to actual ratios.

57. D — Section 179(f) real property: HVAC units, roofs, and fire protection, alarm, and security systems on nonresidential real property are separately eligible for Section 179 expensing, subject to the overall dollar and business-income limits that apply generally. Unlike interior nonstructural improvements, these particular building systems fall outside the QIP definition and cannot instead claim bonus depreciation treatment.

58. A — Section 45F computation: the employer-provided childcare credit equals 25% of qualified childcare facility expenditures plus 10% of qualified childcare resource and referral expenditures. Here, 25% of $300,000 is $75,000, and 10% of $20,000 is $2,000, together totaling $77,000, which falls under the applicable annual cap, so the full $77,000 credit amount is allowable this year.

59. C — MFS allocation rule: spouses filing separately are treated as one taxpayer for purposes of the Section 179 dollar limitation, and absent a joint election specifying a different percentage split, each spouse is automatically allocated 50% of the otherwise-applicable limitation, regardless of how much qualifying property each spouse's business actually placed in service during the year.

60. B — Prior-year loss ordering: Treasury regulations under Section 199A treat losses suspended by basis, at-risk, or passive activity limitations as arising from the earliest disqualified or suspended year once they become allowed, and they reduce QBI in the year they are finally allowed for regular tax purposes, even though the loss economically originated in an earlier tax year.

61. A — Short-year proration: under Reg. 1.168(i)-6 and related MACRS guidance, depreciation for a short tax year is computed by prorating the deduction that would apply for a full twelve-month year based on the number of months in the short period, with the applicable half-year or mid-quarter convention reapplied specifically to that shortened tax period rather than the full year.

62. C — Section 45Q mechanics: the credit is generally available to the taxpayer that owns the carbon capture equipment and physically or contractually ensures the qualified carbon oxide is disposed of in secure storage, used as a tertiary injectant, or otherwise utilized, and is limited to a twelve-year credit period per facility.

63. D — PTC-to-ITC election: Section 48 permits a taxpayer to make an irrevocable election to treat a qualified Section 45 facility, including a wind facility, as energy property, substituting a one-time investment credit based on eligible basis for the ten-year per-kilowatt-hour production tax credit, but the taxpayer may not claim both credits on the same facility.

64. B — Recapture applies only to gains: Sections 1245 and 1250 recharacterize gain recognized on disposition of depreciable property, but neither has any effect when a sale produces a loss instead. The $80,000 loss on this straight-line-depreciated building is simply a Section 1231 loss, which, absent offsetting Section 1231 gains, is generally deductible in full as an ordinary loss.

65. A — SSTB carve-out: Section 199A(d)(2) enumerates fields such as health, law, accounting, consulting, and financial services as SSTBs, but explicitly excludes engineering and architecture from the definition. Because this firm is an engineering business, it is not an SSTB, and the above-threshold phase-out rules for SSTBs do not apply to it.

66. B — Employee Retention Credit mechanics. An eligible employer, including one whose operations were fully or partially suspended by a governmental order, may claim a refundable credit against certain employment taxes based on qualified wages paid to employees, but the same wages cannot be double-counted for both ERC purposes and PPP loan forgiveness purposes.

67. C — USERRA Differential Wage Payments. Differential wage payments are treated as wages for federal income tax withholding under Section 3401(h), but IRS guidance confirms they are excluded from Social Security, Medicare, and FUTA tax because no employment services are being performed while on active duty. Options A, B, and D incorrectly describe the required tax treatment.

68. D — Section 119 lodging exclusion. Employer-provided lodging is excludable from an employee's income when it is furnished on the business premises, for the convenience of the employer, and the employee is required to accept it as a condition of employment. All three conditions are met by the live-in property manager's arrangement here.

69. D — FICA Special Timing Rule. Under Section 3121(v)(2), deferred amounts become subject to FICA tax when services are performed or, if later, when no longer subject to a substantial risk of forfeiture, not when the amount is actually paid to the executive. Choice A describes income tax timing rather than the FICA rule; B and C misstate the triggering event.

70. C — Schedule B Filing Requirement. Semiweekly schedule depositors must complete Schedule B (Form 941), reporting daily tax liability for each pay date within the quarter, and attach it to Form 941; monthly depositors instead report a monthly summary directly on Form 941. Form 8974 relates to the research credit offset and Schedule H applies to household employers, so neither applies here.

71. B — Statutory Employee Treatment. A qualifying statutory employee has Social Security and Medicare tax withheld and reported on Form W-2 with the statutory employee box checked, but no federal income tax withholding applies. Because self-employment tax is not owed, the worker reports income and deducts unreimbursed business expenses on Schedule C. Choices A, C, and D misstate this hybrid classification.

72. A — Working Condition Fringe Benefit. A cell phone provided primarily for noncompensatory business reasons is excludable in full under Section 132(d), and IRS guidance eliminated the need to track or allocate personal versus business use when a substantial business reason predominates. Choices

B, C, and D impose tracking or reimbursement requirements that no longer apply under current guidance.

73. C — Depreciation Recapture on Home Sale. Even when the full gain otherwise qualifies under Section 121, gain attributable to depreciation claimed on a home office after May 6, 1997, cannot be excluded and is taxed as unrecaptured Section 1250 gain, capped at a 25% rate. Choices A, B, and D misstate how depreciation interacts with the residence-sale exclusion.

74. D — Fleet-average valuation rule. An employer maintaining a fleet of 20 or more vehicles that meet the eligibility requirements may elect the fleet-average valuation rule, assigning each vehicle in the fleet an annual lease value based on the fleet's average fair market value rather than valuing each vehicle separately under the general method.

75. B — Nonaccountable Plan Consequences. Because the flat allowance is paid without regard to actual expenses and requires no substantiation or return of excess, the arrangement fails the accountable plan rules under Section 62(c), making the entire amount taxable wages subject to withholding and FICA. Choices A, C, and D describe accountable-plan or independent-contractor treatment that does not apply here.

76. A — Additional Medicare Tax Reconciliation. Employers withhold Additional Medicare Tax only on wages they individually pay above $200,000, but the 0.9% tax actually applies to combined wages above $200,000 for a single filer. The taxpayer reconciles any shortfall on Form 8959 filed with the individual return. Choices B, C, and D misstate the reconciliation mechanism and filing obligation.

77. D — Withholding Calculation Methods. Publication 15-T provides both wage bracket tables and percentage method tables, and employers may choose either method for any employee; both are designed to produce equivalent withholding results for a given wage level and filing status. Choices A, B, and C impose restrictions that do not exist under current withholding computation rules.

78. C — Section 6721 Tiered Penalties. The per-return penalty for incorrect information returns rises in tiers by correction speed: a lower tier applies within 30 days of the deadline, a middle tier applies for corrections after 30 days but by August 1, and the highest tier applies after August 1 or if never corrected. A 45-day correction falls into the middle tier.

79. A — Section 6039 reporting. A corporation must file Form 3921 with the IRS and furnish a copy to the employee for each calendar year in which an incentive stock option is exercised, reporting the transfer of stock. This employer reporting obligation is separate from the option's favorable individual tax treatment and withholding exemption.

80. B — ESBT S portion taxation. Under Section 641(c), the S corporation income allocated to an ESBT's S portion is taxed at the highest trust marginal rate with no exemption or standard deduction, computed separately from the trust's other income, which uses regular graduated trust brackets. Options A, C, and D misstate this bifurcated computation and the flow-through treatment.

81. A — Section 415(b) DB limit. The maximum annual benefit under a defined benefit plan is the lesser of an indexed dollar limit or 100% of the participant's average compensation over their highest three consecutive years, prorated for service under ten years. Options B, C, and D misstate the compensation percentage, averaging period, or omit the required dollar limit.

82. B — Short-term rental exception. Under Reg. 1.469-1T(e)(3), an activity where the average period of customer use is seven days or less is excluded from the 'rental activity' definition entirely, so it is instead tested under the standard material participation tests. Options A, C, and D misapply passive rental treatment or the real estate professional rule.

83. D — Section 2038 retained power. A transfer is includible in the gross estate if the decedent retained, at death, the power to alter, amend, revoke, or terminate beneficiaries' enjoyment of the transferred property, even a power merely to change distribution timing qualifies. Options A, B, and C incorrectly assume only a full revocation power triggers inclusion under this section.

84. C — Quid pro quo disclosure. Under Section 6115, when a donor's payment exceeding $75 is partly a contribution and partly for goods or services, the organization must furnish a written statement disclosing the deductible amount, payment minus fair market value received. Options A, B, and D misstate the deduction, a nonexistent refusal requirement, and UBTI treatment.

85. C — CRP payments and SE tax. Section 1402(a)(1) excludes CRP payments from self-employment income for individuals receiving Social Security retirement or disability benefits who are not otherwise in the trade or business of farming; the payments remain fully taxable as ordinary income. Options A, B, and D misstate the exclusion's scope, its existence, and a nonexistent dollar threshold.

86. D — In-kind distribution basis rule. Under Section 643(e), a trust distributing appreciated property in kind generally recognizes no gain, and the beneficiary takes the trust's carryover basis for DNI purposes; the trustee may instead elect under 643(e)(3) to recognize gain, giving the beneficiary a stepped-up basis. Options A, B, and C misstate the default and elective outcomes.

87. A — Conduit vs. accumulation trust. A conduit trust that must pass through all IRA distributions immediately to the individual beneficiary allows only that beneficiary to be counted as designated beneficiary for RMD purposes; an accumulation trust, which may retain distributions, requires counting every beneficiary who could receive corpus. Options B, C, and D misapply the classification and its consequences.

88. B — Suspended losses at death. Under Section 469(g)(2), death is a qualifying disposition, but suspended losses are deductible on the decedent's final return only to the extent they exceed the basis step-up under Section 1014; any suspended loss absorbed by the step-up is permanently lost, not carried over. Options A, C, and D misstate the limitation, triggering event, or carryover.

89. B — 501(c)(4) vs 501(c)(3). Section 501(c)(4) social welfare organizations may conduct substantially more lobbying and some political activity than 501(c)(3) charities, which face an absolute campaign-intervention ban and lobbying limits, but donor contributions to 501(c)(4)s are generally not tax-deductible. Options A, C, and D misstate the political restrictions and deductibility rules for each classification.

90. A — Present interest requirement. Section 2503(b)'s annual exclusion applies only to gifts of a present interest, an unrestricted right to immediate use, possession, or enjoyment; a remainder interest, postponed until a prior interest ends, is a future interest and never qualifies, regardless of value. Options B, C, and D wrongly assume automatic qualification, a dollar cap, or a nonexistent election.

91. D — Section 180 land fertilization election. Farmers may elect to currently deduct expenditures for fertilizer, lime, and similar soil-enriching materials in the year paid or incurred rather than capitalizing them, even though the benefit is not exhausted within that year. Options A, B, and C incorrectly require capitalization, mandatory amortization, or deny any deduction whatsoever.

92. C — Aggregate 402(g) limit. The elective deferral limit applies per individual across all employer plans combined, not per plan; when deferrals to unrelated employers' plans exceed the limit, the employee must request a corrective distribution of the excess plus earnings by the applicable deadline to avoid double taxation. Options A, B, and D misstate the aggregation rule and correction responsibility.

93. C — 2032A reduction cap. Section 2032A(a)(2) limits the total value reduction from special use valuation to an indexed statutory maximum for the applicable year; the estate may still elect special use valuation, but the benefit is capped there even where the actual-use reduction would otherwise be larger. Options A, B, D misstate an unlimited reduction, an incorrect formula, and improper disallowance.

94. A — Bingo games exception. Section 513(f) excludes traditional bingo games from unrelated trade or business treatment when the games are legal under applicable state and local law and are not conducted on a commercial basis by for-profit entities in that jurisdiction. Options B, C, and D misstate automatic inclusion, a nonexistent donation requirement, and a nonexistent frequency limit.

95. B — CLUT structure. A charitable lead unitrust pays the charity a fixed percentage of trust assets as revalued annually, so payments fluctuate with asset value, distinguishing it from a charitable lead annuity trust, which pays a fixed dollar amount set at inception. Options A, C, and D misidentify the payment structure or reverse the charitable and noncharitable interests.

96. D — Excess Roth contribution excise tax. An ineligible or over-the-limit Roth IRA contribution left in the account is subject to a 6% excise tax under Section 4973 for each year it remains uncorrected, unless timely withdrawn with earnings by the return's due date, including extensions. Options A, B, and C misstate enforceability, automatic custodial rejection, and automatic recharacterization.

97. C — Nonqualified use allocation. Under Section 121(b)(5), gain attributable to periods of nonqualified use after 2008, such as prior rental use before conversion to a principal residence, is allocated based on the ratio of nonqualified-use time to total ownership time and is ineligible for exclusion. Options A, B, and D misstate full qualification, total disqualification, or the exclusion amount.

98. D — Extended disaster replacement period. Under Section 1033(e), livestock sold because of drought, flood, or other weather-related conditions qualifies for involuntary conversion deferral, and Section 1033(h) extends the normal 2-year replacement period to 4 years when the sale occurs in an area eligible for federal disaster assistance. Options A, B, and C misstate the period length or wrongly deny eligibility.

99. A — Section 2039 annuity inclusion. A survivor's annuity payable under an employer-funded plan by reason of surviving the decedent is included in the gross estate under Section 2039, based on the portion attributable to employer contributions, though the surviving spouse beneficiary still allows a marital deduction. Options B, C, D misstate exclusion, a nonexistent 50% rule, and income-tax treatment.

100. B — Governmental vs. top-hat 457(b). A governmental 457(b) plan must hold assets in trust for the exclusive benefit of participants, while a nongovernmental top-hat 457(b) plan sponsored by a private employer cannot use a trust and remains subject to the employer's general creditors, creating unfunded deferred compensation. Options A, C, and D reverse or misstate this asset-protection distinction and eligibility scope.