PRACTICE EXAM 25: SEE PART 2 — BUSINESSES (100 QUESTIONS)

This full-length simulation exam contains 100 multiple-choice questions covering SEE Part 2: Businesses, built to mirror the domain weighting of the official IRS Special Enrollment Examination. The official Part 2 exam, administered by PSI Services LLC, consists of 85 scored questions (plus unscored pretest questions) with a 3.5-hour time limit; this practice exam is expanded to 100 questions per the book's practical question-count override so that the total practice question bank across all Part 2 exams reaches a useful study volume, while domain weighting percentages are scaled proportionally from the official 85-question breakdown. For the most realistic practice, allow yourself 3.5 hours to complete this exam without interruption, using only scratch paper and a basic calculator as permitted at the PSI test center. The IRS-published passing score is a scaled score of 500 or higher on a 200-800 scale. Mark your answer for each question, then check your work against the Answer Key and Explanations section that follows. For an interactive, timed practice experience, use the Online Exam Simulator included with this book.

1. Meridian Trail Partners, a five-partner general partnership, files its Form 1065 for the current tax year. Under IRC Section 6063 and related Treasury regulations, who is authorized to sign the partnership's return on the partnership's behalf?

A. Every general partner in the partnership must sign jointly.
B. Any one partner, or LLC member-manager, is authorized to sign.
C. Only the managing partner named in the partnership agreement may sign.
D. The partnership's outside paid preparer signs in place of a partner.

2. Sterling & Cobb Partners, a domestic four-partner general partnership, files its Form 1065 six months late with no extension and owes no tax at the entity level. Which statement correctly describes the Section 6698 late-filing penalty?

A. The penalty applies per partner per month even though no tax is owed.
B. No penalty applies because partnerships never owe tax at the entity level.
C. The penalty is capped at a flat $500 regardless of partner count.
D. The penalty applies only if the partners also file individually late.

3. Following a Section 754 election, Foxglove Partners must allocate a $60,000 Section 743(b) basis adjustment attributable to a purchasing partner. Under Section 755, how must this adjustment be allocated among the partnership's assets?

A. Equally across every asset regardless of type or value.

B. Entirely to goodwill regardless of the value of other assets.

C. Among asset classes by relative appreciation, ordinary-income versus capital assets, using Section 1060 principles.

D. Entirely to whichever specific asset the purchasing partner selects.

4. Wexford Development Partners allocates 40% of profits to Partner Aldous, a purported partner whose allocation and near-certain distribution are tied directly to development-management services he performs, with the allocation transferring almost no entrepreneurial risk of loss to him. Under Section 707(a)(2)(A), how should this arrangement be treated?

A. As a normal distributive share reported on Aldous's Schedule K-1.

B. As a tax-free return of Aldous's contributed capital.

C. As a guaranteed payment for the use of capital only.

D. As a disguised payment for services, taxed as ordinary compensation.

5. After the IRS issues a Final Partnership Adjustment (FPA) to Cormorant Partners under the BBA centralized audit regime, and the partnership disagrees, in which forum(s) may the partnership representative seek judicial review under Section 6234?

A. Only the local state trial court where the partnership is located.

B. The Tax Court, a federal district court, or the Court of Federal Claims.

C. Binding arbitration administered exclusively by the IRS Office of Appeals.

D. No judicial review is available once an FPA is issued.

6. Bellwood Partners is a calendar-year general partnership. After timely filing Form 7004, what extended due date applies to its Form 1065 for the tax year?

A. September 15, a six-month extension from the March 15 due date.
B. October 15, matching the extended due date for individual returns.
C. June 15, a three-month extension only.
D. December 15, a nine-month extension from the original due date.

7. Warrick gifts a 30% capital interest in Thistledown Farms, a capital-intensive family partnership, to his daughter Noor, who performs no services for the business. Warrick continues to perform substantial management services for the partnership. Under Section 704(e), what must occur before the remaining income is divided according to capital ownership?

A. Noor's allocated share must automatically be reduced to zero.
B. The partnership must reclassify Noor's interest as a profits interest.
C. Noor must reimburse Warrick for the fair market value of the gift.
D. Warrick must first receive reasonable compensation for his services before dividing the remainder by capital.

8. Halvorsen Capital Partners incurs $22,000 in printing costs for its private placement memorandum used to solicit new limited partner investors, separate from its legal fees for drafting the partnership agreement. How must the $22,000 printing cost be treated?

A. Amortized ratably over 180 months as an organizational expenditure.
B. Deducted in full in the year the printing costs are paid.
C. Capitalized as a syndication cost, with no amortization or deduction allowed.
D. Expensed immediately up to a $5,000 first-year safe harbor.

9. Thornbury Capital LLC, a partnership engaged in a U.S. trade or business, has a nonresident alien partner, Anders, who sells his entire 15% partnership interest to an unrelated U.S. buyer for $500,000. Under Section 1446(f), what is the buyer's general withholding obligation on this purchase?

A. The buyer has no withholding obligation, since Section 1446(f) applies only to withholding on partnership income allocations, not interest sales.

B. The partnership itself, not the buyer, is solely responsible for withholding a flat 21% corporate rate on the sale proceeds.
C. Withholding applies only if Henrik fails to file a U.S. tax return reporting the sale within 90 days of closing.
D. The buyer must withhold 10% of the amount realized on the sale and remit it to the IRS, subject to certain exceptions and certifications.

10. Partner Idris purchases a 20% interest in Thackeray Partners on July 1, causing a mid-year change in partnership interests. Which methods may the partnership use under Section 706(d) to allocate income between the pre- and post-change periods?

A. Only an equal daily allocation across the full twelve months.
B. Only a special allocation approved unanimously by all partners.
C. An interim closing of the books or a proration method.
D. A retroactive allocation applied entirely to the following tax year.

11. Partner Selene receives a Schedule K-1 from Corvid Partners reporting $18,000 of ordinary business income, but she believes the amount is incorrect. Under Section 6222, what must Selene do if she wants to report the item differently on her own return?

A. File Form 8082 to notify the IRS of the inconsistent treatment.
B. Simply report the different amount with no additional disclosure required.
C. Wait for the partnership to amend its return before filing hers.
D. Request that the IRS audit the partnership before filing her own return.

12. Rosalind Partners specially allocates nonrecourse deductions to Partner Voss under a partnership agreement that lacks a deficit restoration obligation. For this allocation to have substantial economic effect despite being funded by nonrecourse debt, what must the partnership agreement satisfy under the partnership minimum gain chargeback requirement of Reg. Section 1.704-2?

A. Voss must personally guarantee repayment of the underlying nonrecourse debt before any allocation is respected.

B. The agreement must require partners to be allocated income offsetting prior nonrecourse deductions in proportion to their share of minimum gain whenever it decreases.

C. The partnership must convert the nonrecourse debt into recourse debt before any nonrecourse deduction may be allocated.

D. Nonrecourse deductions may never be specially allocated under any circumstance, regardless of the agreement's terms.

13. Devlin, an accrual-basis sole proprietor operating a computer repair business, determines that a $6,000 trade receivable from a customer has become 40% worthless during the year, though not entirely uncollectible. How is this bad debt treated?

A. No deduction is allowed until the debt becomes wholly worthless.

B. Devlin may deduct the partial worthlessness as an ordinary business bad debt.

C. It is treated as a short-term capital loss for the worthless portion.

D. The deduction is limited to $3,000 under the capital loss rules.

14. Marcus, an unmarried sole proprietor, has $240,000 of net self-employment earnings this year. Beyond the regular 15.3% SE tax, how does the 0.9% Additional Medicare Tax apply to his self-employment income?

A. It applies to his full self-employment earnings with no threshold.

B. It is matched by an equivalent employer-side deduction, as with regular SE tax.

C. It applies only to earnings above $200,000, with no matching deduction allowed.

D. It replaces the Medicare portion of his regular SE tax entirely.

15. Farida operates her floral shop as a sole proprietorship and employs her 16-year-old son Amir after school. Under Section 3121(b)(3), how are Amir's wages treated for FICA purposes?

A. Fully subject to FICA the same as any unrelated employee.

B. Subject to FICA only if Amir earns above $2,500 for the year.

C. Exempt from FICA only if the business is incorporated.

D. Exempt from FICA because the business is a sole proprietorship owned by his parent.

16. Oakley runs a small sole proprietorship woodworking shop and does not have an applicable financial statement (AFS). Under the de minimis safe harbor election of Reg. Section 1.263(a)-1(f), what is the maximum amount per invoice or item that Oakley may currently expense rather than capitalize?

A. $2,500 per invoice or item, since no AFS exists.
B. $5,000 per invoice or item, regardless of AFS status.
C. $500 per invoice or item, with no election required.
D. $10,000 per invoice or item, matching the Section 179 threshold.

17. A fire destroys equipment used in Renata's sole proprietorship woodshop, causing a fully deductible casualty loss of $14,000 not covered by insurance. How does this business casualty loss differ from a personal-use-property casualty loss?

A. It is deductible in full, without the $100 floor or federally-declared-disaster requirement.
B. It is deductible only above 10% of Renata's adjusted gross income.
C. It requires a federally declared disaster to be deductible at all.
D. It is limited to the lesser of basis or a $3,000 cap.

18. Owen, a sole proprietor, trades in an old delivery truck used exclusively in his business for a new delivery truck of like kind, intending to defer gain recognition. Under current law, can Owen use Section 1031 like-kind exchange treatment for this transaction?

A. Yes, because personal property used in a trade or business always qualifies.
B. Yes, but only if the trucks are traded through a qualified intermediary.
C. Yes, but gain deferral is capped at $25,000 for vehicle trades.
D. No, because Section 1031 now applies only to exchanges of real property.

19. Hollis Doyle, the sole shareholder of Meridian Fabrication Inc., an S corporation, transfers his shares into a properly structured voting trust as part of an estate plan. The trust instrument gives the trustee all voting rights, requires trust income to be distributed currently to the beneficiaries, and otherwise satisfies the specific statutory conditions applicable to voting trusts. All beneficiaries are U.S. citizens. Does the S election remain valid?

A. No, because any trust holding S-corporation stock automatically terminates the corporation's election under §1361(b)(1)(B).

B. No, because only grantor trusts and testamentary trusts are ever permitted to hold S-corporation stock.

C. Yes, because a voting trust meeting the statutory requirements of §1361(c)(2)(A)(iv) is a permitted shareholder, and each beneficiary is counted separately.

D. Yes, but only for a two-year grace period after which the trust must distribute the shares outright to the beneficiaries.

20. Individual investor Priya owns shares of Nordholm AS, a corporation organized in Norway whose stock trades exclusively on the Oslo Stock Exchange and not on any established U.S. securities market. The United States maintains a comprehensive income tax treaty with Norway that includes an exchange-of-information program. Priya receives a $4,000 dividend from Nordholm. Does this dividend qualify for the reduced 'qualified dividend' tax rates?

A. No, because dividends from any foreign corporation are automatically excluded from qualified dividend treatment regardless of treaty status.

B. Yes, because Nordholm is a 'qualified foreign corporation' under the comprehensive U.S.-Norway treaty, even though its stock is not traded on a U.S. exchange.

C. Yes, but only if Priya also elects to treat the dividend as effectively connected income on her U.S. return.

D. No, because qualified dividend treatment always requires the paying corporation's stock to trade on a U.S. securities market.

21. Ashgrove Parent Corp owns 100% of Delmore Sub Inc. and the two file a consolidated return. Parent's basis in Delmore's stock is $200,000. In the current year, Delmore reports $50,000 of taxable income, and in the following year it incurs an $80,000 net operating loss. Under the consolidated return investment adjustment rules, how is the $80,000 loss treated to the extent it exceeds Parent's adjusted basis?

A. The excess loss is currently disallowed entirely and permanently lost, since basis cannot be reduced below zero.

B. The excess loss immediately triggers mandatory deconsolidation of Delmore from the group under §1504.

C. The excess creates an excess loss account, functioning as negative basis, which is includible in income or reduces future basis upon a triggering event.

D. The excess loss is suspended and can only be used to offset Delmore's own income in future years, never Parent's.

22. Nadia Reyes, an individual investor (not a corporation), purchases 100% of the outstanding stock of Vesper Corp, an eligible S corporation, from its shareholders. Both Nadia and the selling shareholders want the transaction taxed as a deemed sale of Vesper's underlying assets rather than as a stock sale. Because Nadia is an individual purchaser, can the parties make a §338(h)(10) election?

A. No; §338(h)(10) requires a corporate purchaser, but the parties may instead make a §336(e) election, which permits deemed-asset-sale treatment regardless of the purchaser's form.

B. Yes; §338(h)(10) has no purchaser-type restriction and applies identically whether the buyer is an individual or a corporation.

C. No; individual purchasers of S-corporation stock can never obtain deemed-asset-sale treatment under any Code section.

D. Yes, but only if Nadia first forms a corporation and contributes the purchase funds to it before closing.

23. Cobalt Fixtures Inc., an accrual-basis C corporation, is majority-owned by Owen Marsh. At year-end, Cobalt accrues $18,000 of rent payable for warehouse space owned by Owen's minor daughter, who is treated as a related party through family attribution under §267(c) and reports income on the cash basis. Cobalt does not actually pay the rent until March of the following year. When may Cobalt deduct the $18,000?

A. In the current year, because accrual-basis taxpayers deduct accrued expenses in the year the liability becomes fixed, regardless of relatedness.

B. In the following year, because §267(a)(2) defers the related payer's deduction until the year the related cash-basis payee actually includes the payment in income.

C. The deduction is permanently disallowed in full because the payee is a related minor child under family attribution.

D. Cobalt may deduct 50% currently and defer the remaining 50% until payment, similar to the meals deduction limitation.

24. Renner Fabrication Inc., a closely held C corporation, pays its sole shareholder-employee, Talia Renner, an annual salary of $450,000 for duties that comparable executives in the industry perform for approximately $180,000. On examination, the IRS determines the excess $270,000 is unreasonable compensation. What is the proper treatment of the excess amount?

A. The full $450,000 remains fully deductible because a corporation may deduct any amount it chooses to pay its own employees.

B. The excess $270,000 is deductible by the corporation but excluded from Talia's taxable income as a return of capital.

C. The excess $270,000 must be repaid to the corporation within 90 days to avoid any adverse tax consequence to either party.

D. The IRS may disallow the deduction for the excess under §162(a)(1) and recharacterize it as a nondeductible constructive dividend taxable to Talia.

25. Bianca Ostrow completely terminates her direct 40% stock interest in Fairwind Corp in a redemption, but her adult son continues to own the remaining shares. To avoid family attribution from her son under §318 and obtain exchange treatment on the complete termination, what must Bianca do under §302(c)(2)?

A. Nothing further; complete terminations automatically waive family attribution without any filing or retained-interest restriction.

B. She must sell her interest to an unrelated third party rather than have it redeemed directly by the corporation.

C. She must wait five years after the redemption before any waiver of family attribution becomes effective under the statute.

D. She must retain no interest other than as a creditor, avoid acquiring any prohibited interest for 10 years, and attach a notification agreement to her return.

26. Ashford Corp, a C corporation, sells a commercial office building that had been depreciated using the straight-line method, generating no §1250 recapture because all depreciation was straight-line. Total depreciation claimed on the building was $100,000. Under the corporate depreciation recapture preference cutback, what additional amount must Ashford treat as ordinary income?

A. $0, because straight-line depreciation on real property never generates any additional recapture under any Code provision.

B. $100,000, because corporations must recapture all depreciation claimed on real property as ordinary income upon sale.

C. $20,000, because §291(a)(1) treats 20% of the amount that would have been §1245 recapture as additional ordinary income.

D. $40,000, because corporations recapture depreciation on real property at twice the individual taxpayer recapture rate.

27. Pinegate Corp acquires substantially all the operating assets of Larkspur Co. in a taxable asset purchase and, applying the residual method, allocates $600,000 of the purchase price to acquired goodwill. For federal income tax purposes, how must Pinegate amortize this goodwill?

A. Ratably over a fixed 15-year period under §197, or $40,000 per year, regardless of goodwill's actual estimated useful life.

B. Over the same useful life used for financial statement purposes, which may differ significantly from any fixed statutory period.

C. Goodwill acquired in an asset purchase is never amortizable for tax purposes and remains a permanent capital asset.

D. Over a 5-year period matching the amortization period allowed for organizational and start-up expenditures under §248 and §195.

28. Eighteen months before Cresthaven Corp's board adopted a formal plan of complete liquidation, its majority shareholder contributed land with a basis of $90,000 and a fair market value of $60,000 to the corporation in a §351 transaction. Upon liquidation, the land, still worth $60,000, is distributed pro rata to all shareholders. May Cresthaven recognize the $30,000 built-in loss on the distribution?

A. Yes, because §336(d) only disallows built-in losses on non-pro-rata distributions to related shareholders, and this distribution was pro rata.

B. No, because the land was contributed within two years before the plan of liquidation, so §336(d)(2) presumes a tax-avoidance purpose and disallows the built-in loss.

C. Yes, because built-in losses on liquidating distributions are always fully recognized once the corporation has held the property for more than one year.

D. No, because liquidating corporations may never recognize losses on any distributed property regardless of when or how it was acquired.

29. Corliss Whitfield sells depreciable manufacturing equipment with an adjusted basis of $20,000 to Whitfield Tooling Corp, a corporation she owns 100%, for $80,000, receiving $20,000 down and the $60,000 balance under a four-year installment note. May Corliss report her gain using the installment method?

A. No; §453(g) bars installment reporting for sales of depreciable property between related parties under §1239(b), so the entire $60,000 gain is recognized in the year of sale absent proof of no tax-avoidance purpose.

B. Yes; installment reporting is always available for any bona fide sale supported by a properly documented promissory note.

C. No; related-party sales of any kind are entirely prohibited under §267 and cannot occur even at fair market value.

D. Yes, but only the portion of gain attributable to the $20,000 down payment may be reported currently, with the rest deferred indefinitely.

30. Marisol Trent sold undeveloped land with a basis of $150,000 to her wholly owned corporation for $110,000, and her resulting $40,000 loss was disallowed under §267(a)(1). Two years later, the corporation sells the land for $135,000. How much gain must the corporation recognize?

A. $25,000, because §267(d) never permits any offset for a previously disallowed related-party loss regardless of subsequent events.

B. $0, because §267(d) lets the corporation offset its $25,000 realized gain with Marisol's $40,000 disallowed loss, though the unused $15,000 provides no further benefit.

C. $40,000, because the corporation must recognize gain measured against Marisol's original $150,000 basis rather than its own cost basis.

D. $15,000, because only the portion of the disallowed loss exceeding the realized gain may be used to reduce recognized gain.

31. In Year 1, Desmond Okafor's stock basis in Larkin Metals Inc., an S corporation, is zero, causing $12,000 of his pro rata share of the corporation's loss to be suspended under the basis limitation rules. In Year 3, Desmond makes an additional $20,000 capital contribution that restores sufficient basis. What happens to the $12,000 suspended loss?

A. It is permanently forfeited because §1366(d) losses not deducted in the year incurred can never be used in a later year.

B. It may only offset future capital gains recognized by Desmond, similar to a suspended passive activity loss carryforward.

C. It carries forward indefinitely under §1366(d)(2) and becomes deductible in Year 3 once basis is restored, subject to at-risk and passive-activity limits.

D. It automatically converts into additional paid-in capital rather than remaining available as a deductible pass-through loss.

32. Meridian Distributing Corp spins off its packaging division as Controlled Corp to its shareholders in a transaction otherwise qualifying under §355. Fourteen months later, pursuant to a plan negotiated with the acquirer before the spin-off, an unrelated buyer purchases 60% of Controlled's stock. What is the corporate-level consequence to Distributing under §355(e)?

A. None; §355(e) applies only to acquisitions of Distributing's own stock, never to acquisitions of Controlled's stock.

B. None; because the shareholders' receipt of Controlled stock remains tax-free, no corporate-level gain can ever be triggered under §355.

C. Distributing recognizes ordinary income equal to its historic earnings and profits attributable to the packaging division at the time of the spin-off.

D. Distributing recognizes gain as if it sold the Controlled stock for fair market value, because 50% or more was acquired within two years under a related plan.

33. Vantar LP's limited partnership interests trade on an established securities market. For the current year, only 60% of Vantar's gross income consists of interest, dividends, real property rents, and other qualifying passive-type income described in §7704(c). How is Vantar classified for federal tax purposes?

A. Vantar remains a partnership regardless of its income mix, since publicly traded status alone never affects entity classification.

B. Vantar is taxed as a corporation because §7704 requires at least 90% qualifying passive-type income for the publicly traded partnership exception, and Vantar's 60% fails that threshold.

C. Vantar automatically becomes a disregarded entity because it failed the qualifying-income test for partnership treatment.

D. Vantar may elect either partnership or corporate treatment annually on Form 8832 regardless of its income composition.

34. Foster Whitlock, a 50% shareholder of Larkin Inc., an S corporation, dies on June 30, leaving his shares to his estate. The corporation's remaining 50% shareholder wants income allocated based on the corporation's actual books through the date of death rather than a simple daily proration. Absent any election, how is the corporation's income allocated between Foster's estate and the surviving shareholder?

A. Income must be allocated entirely to the surviving shareholder because a deceased shareholder's estate cannot receive any pass-through income.

B. A closing-of-the-books allocation applies automatically upon a shareholder's death without any election or shareholder consent required.

C. The default is per-share-per-day allocation under §1377(a)(1), but with consent of all affected shareholders, a §1377(a)(2) election permits closing-of-the-books allocation instead.

D. The corporation must file two separate short-year S-corporation returns regardless of which allocation method the shareholders prefer.

35. Acquiring Corp merges with Target Corp in a transaction structured to qualify as a Type A statutory merger. After the merger, Acquiring must satisfy the judicially and regulatorily developed Continuity of Business Enterprise requirement, separate from continuity of shareholder interest. What does this requirement demand?

A. Acquiring must retain at least 50% of Target's former employees in their same positions for a minimum of two years.

B. Acquiring must issue continuing dividends to former Target shareholders at the same rate Target paid before the merger.

C. Acquiring must obtain a private letter ruling from the IRS confirming satisfaction of continuity before the merger can close.

D. Acquiring must either continue Target's historic business or use a significant portion of Target's historic business assets in a business.

36. Foster sold a piece of business equipment to Briggs for $180,000, to be paid in three equal annual installments of $60,000 beginning one year after the sale. The contract states no interest rate, and the applicable federal rate (AFR) is 5%. Under Sections 483 and 1274, how must the payments be treated for tax purposes?

A. Each $60,000 payment must be recharacterized into principal and imputed interest components using the AFR, with the interest portion taxed as ordinary income to Foster.

B. No imputation is required because the parties are unrelated and dealt at arm's length.

C. The full $180,000 sale price is treated as principal, and Briggs may deduct interest only when actually paid.

D. Imputed interest applies only if the sale price exceeds $500,000, the threshold under Section 483.

37. Vance owns 10,000 shares of Delmar Corp. stock with a basis of $40,000 and a current fair market value of $150,000. On November 1, 2025, Vance enters into a short sale against the box, selling short 10,000 shares of identical Delmar stock without closing out his long position by year-end. Under Section 1259, what is the tax consequence?

A. No gain is recognized until Vance actually delivers stock to close the short sale in a future year.

B. Vance recognizes a $110,000 loss because the short sale locks in his position at year-end value.

C. Vance recognizes a $110,000 gain as if the appreciated position were sold at fair market value on the date of the constructive sale.

D. The transaction is disregarded entirely because both positions remain open at year-end.

38. Meadowbrook Farms, a sole proprietorship reporting on Schedule F, generates a $220,000 net operating loss for 2025 attributable entirely to its farming business. Absent any special election, what carryback period applies to this farming loss under Section 172?

A. The loss must be carried forward only; no carryback is permitted for any NOL after 2017.

B. The farming loss is eligible for a 2-year carryback unless the taxpayer elects to forgo it.

C. The farming loss must be carried back exactly 5 years, matching the pre-2018 general NOL rule.

D. The farming loss may be carried back 10 years because it arises from a natural disaster.

39. In 2023, Halvorsen included $80,000 of commission income under a claim of right and paid tax reflecting a 32% marginal rate that year. In 2025, a court ruled Halvorsen was not entitled to $80,000 of that income, and he repaid it. His 2025 marginal rate is 24%. Under Section 1341, how does Halvorsen compute the most favorable result?

A. Halvorsen compares the tax reduction from deducting $80,000 in 2025 against the tax decrease had the $80,000 been excluded in 2023, claiming whichever is greater.
B. Halvorsen must deduct the $80,000 in 2025 at his current 24% marginal rate, with no alternative computation ever available to him.
C. Halvorsen must amend his original 2023 tax return to remove the $80,000, regardless of any statute-of-limitations concerns.
D. Halvorsen may only carry the $80,000 forward as a net operating loss deduction into future tax years.

40. Chandler sold a commercial building held for investment using the installment method, generating $6 million of deferred installment obligations outstanding at the close of 2025. Total face amount of installment obligations from sales exceeding $150,000 that arose during the year and remain outstanding exceeds $5 million. What additional tax consequence applies under Section 453A?

A. Chandler must recognize the entire $6 million gain immediately in 2025 despite using the installment method.
B. Chandler loses installment-method eligibility retroactively and must amend all prior returns.
C. No additional tax applies because Section 453A only affects dealer property, which this building is not.
D. Chandler owes an interest charge on the deferred tax attributable to the portion of outstanding obligations exceeding $5 million.

41. Bramstead Homes, a homebuilder, enters a contract in March 2025 to construct a single-family residence, expected to be completed in 14 months. Bramstead's average annual gross receipts for the three preceding tax years were $28 million. Which accounting method may Bramstead use for this contract?

A. Bramstead must use the percentage-of-completion method because its gross receipts exceed the small-contractor threshold.
B. Bramstead may use the completed-contract method because the contract qualifies as a home-construction contract regardless of its gross-receipts size.

C. Bramstead may use the completed-contract method only if its average gross receipts fall below $25 million.

D. Bramstead must use the cash method because the contract will be completed within two years.

42. Delacroix Corp purchased all the assets of a business from its majority shareholder's brother, a related party under the attribution rules, acquiring goodwill previously held (but not amortized) by the brother since 1990. Under the Section 197 anti-churning rules, how must Delacroix treat this goodwill?

A. Delacroix may amortize the goodwill over 15 years like any other Section 197 intangible acquired after 1993.

B. Delacroix may immediately expense the goodwill because it was not previously amortized by the related seller.

C. Delacroix must capitalize the goodwill but may begin 15-year amortization once five years have passed.

D. Delacroix may not amortize the goodwill at all because the anti-churning rules bar amortization of intangibles acquired from a related party who held them before the effective date.

43. Ridgeline Motors, an automobile dealership, incurs floor-plan financing interest to fund its new-vehicle inventory. How does this floor-plan financing interest interact with the Section 163(j) business interest expense limitation?

A. Floor-plan financing interest is fully subject to the 30%-of-ATI limitation like all other business interest.

B. Floor-plan financing interest is disallowed entirely and must be capitalized into inventory cost under Section 263A.

C. Floor-plan financing interest is excluded from the Section 163(j) limitation, but the dealership then loses eligibility for full bonus depreciation.

D. Floor-plan financing interest is deductible only up to $25,000 per year regardless of taxable income.

44. Vantage Grain Co. enters into futures contracts to hedge the price risk of wheat inventory it will purchase for its milling operations, properly identifying the transaction as a hedge under Reg. Section 1.446-4 at inception. How must Vantage treat gains and losses on these hedging contracts?

A. As ordinary gains and losses, matched to the timing of the hedged inventory purchase, rather than capital gains and losses.

B. As long-term capital gains or losses regardless of how long the futures contracts were held.

C. As Section 1256 contracts subject to mandatory 60/40 mark-to-market treatment despite the hedge identification.

D. As tax-exempt income to the extent gains offset losses on the underlying inventory purchase.

45. Okafor originally invested $80,000 in Section 1244 qualifying small business stock in a domestic corporation. The stock becomes worthless in 2025. Okafor is single. How much of the loss may Okafor treat as an ordinary loss under Section 1244?

A. None of the loss qualifies as ordinary; all $80,000 is a capital loss.

B. The entire $80,000 loss is ordinary with no dollar limitation for single filers.

C. Up to $50,000 of the loss is ordinary, and the remaining $30,000 is a capital loss.

D. Up to $100,000 of the loss is ordinary because Section 1244 applies the joint-filer limit to all taxpayers.

46. Investor Callum sells short 500 shares of Larkfield Corp stock he does not already own, then purchases 500 shares eight months later to close the short sale at a lower price, realizing a gain. Under Section 1233, how is Callum's holding period for this short-sale gain determined?

A. By the length of time Callum held the short position open, from the sale date to the closing purchase date.

B. By the holding period of the shares used to close the sale, generally treating a same-day closing purchase as producing short-term gain.

C. Short sales are always treated as producing long-term capital gain regardless of any holding period.

D. The holding period is irrelevant because gains on short sales are automatically ordinary income.

47. Corrigan Corp owns 100% of the stock of its subsidiary, Vellum Inc., which meets the affiliation requirements of Section 165(g)(3) because at least 90% of its gross receipts are from sources other than passive investment income. Vellum's stock becomes completely worthless in 2025, and Corrigan's basis in the stock is $2 million. How is Corrigan's loss treated?

A. The loss is a long-term capital loss because worthless stock is always deemed sold on the last day of the year.

B. The loss is a short-term capital loss because worthlessness is treated as occurring on the date of discovery.

C. Half of the loss is capital and half is ordinary under the mixed-character rule for subsidiaries.

D. The loss is an ordinary loss because Section 165(g)(3) treats worthless stock of a qualifying affiliated subsidiary as arising from a non-capital asset.

48. Delacroix sold farmland along with an unharvested corn crop still growing on it to the same buyer in a single transaction. The farmland qualifies as Section 1231 property. Under Section 1231(b)(4), how is the unharvested crop treated?

A. The unharvested crop is Section 1231 property if land and crop are sold to the same buyer in one sale and the land meets the holding period.

B. The unharvested crop is always ordinary income, because growing crops are treated as inventory in a farmer's hands.

C. The unharvested crop must be reported separately from the land sale, using the installment method exclusively.

D. The unharvested crop qualifies for Section 1231 treatment only when sold to a different buyer than the land itself.

49. Whitfield transferred its regional franchise rights to an unrelated party but retained the right to approve any assignment of the franchise by the transferee and the right to prescribe standards for goods sold under the franchise. Under Section 1253, how is Whitfield's gain on the transfer treated?

A. The gain is entirely capital because a franchise is a Section 197 intangible.

B. The gain is entirely Section 1231 gain because the franchise was a business asset.

C. The gain is tax-deferred under the like-kind exchange rules applicable to intangible property.

D. The gain is treated as ordinary income because Whitfield retained significant power, right, or continuing interest in the franchise.

50. Sorensen Manufacturing excluded $300,000 of cancellation-of-debt income from gross income under the insolvency exclusion. Sorensen elects to apply the entire reduction to depreciable business property under Section 1017. What is the effect on Sorensen's depreciable property?

A. Sorensen must reduce the basis of its depreciable property by up to $300,000, which reduces future depreciation deductions on that property.

B. Sorensen's depreciable property basis is unaffected because Section 1017 applies only to real property held for investment.

C. Sorensen must immediately recognize $300,000 of income in the year of the election, negating the exclusion.

D. Sorensen may increase the basis of its depreciable property by $300,000 to reflect the excluded income.

51. Solaris Grid LLC places in service a $4,000,000 solar energy facility in 2025, located in a census tract that qualifies as an 'energy community' under the Inflation Reduction Act because of a brownfield site and historical fossil-fuel employment. Beyond the base 30% Section 48 investment tax credit rate, what additional credit percentage does the energy community location provide?

A. No additional credit; energy community location only affects Section 45 production tax credit eligibility, not Section 48.

B. An additional 10 percentage points, increasing the credit rate to 40% for qualifying energy community property.

C. An additional 2 percentage points, increasing the credit rate to 32% for qualifying energy community property.

D. The energy community bonus doubles the base credit rate to 60% for qualifying property.

52. Coastal Rentals LLC owned a nonresidential rental building placed in service in 1985 and depreciated it using an accelerated method under ACRS. The building is sold in 2025 for a gain, with $40,000 of depreciation claimed in excess of what straight-line would have allowed over the same period. How is this excess, or additional depreciation, treated under Section 1250?

A. Entirely capital gain, since Section 1250 recapture no longer applies to any real property

B. Excluded from gain entirely because the property was placed in service before 1987

C. Taxed as ordinary income to the extent of the $40,000 excess depreciation

D. Taxed entirely at the 25% unrecaptured Section 1250 rate as investment income

53. In 2023, Bristol Tool Co. made a Section 179 election on its timely filed return for $50,000 of manufacturing equipment. In 2025, Bristol's owner wants to revoke that election entirely. What does current tax law permit?

A. Bristol may revoke the election without IRS consent by filing an amended return for the election year
B. Bristol must obtain IRS consent through a private letter ruling before revoking the election
C. The election is irrevocable once made and can never be changed under any circumstances
D. Bristol may revoke the election only if the equipment is sold within the same tax year

54. An office building owner made nonstructural interior improvements to leased office space in 2018. Due to a drafting error in the Tax Cuts and Jobs Act, qualified improvement property (QIP) was initially assigned a 39-year recovery period and excluded from bonus depreciation. Which later legislation retroactively fixed QIP to a 15-year recovery period and restored bonus eligibility back to 2018?

A. The Tax Cuts and Jobs Act itself, effective immediately upon enactment
B. The Protecting Americans from Tax Hikes (PATH) Act of 2015
C. The Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020
D. The Inflation Reduction Act of 2022

55. Meridian Solar Partners, a partnership with no tax-exempt owners, generates a $500,000 Section 48 investment tax credit in 2025 but has minimal tax liability this year. Under the Inflation Reduction Act, what mechanism allows Meridian to sell this credit to an unrelated third party for cash?

A. A direct pay election under Section 6417, since Meridian is a taxable entity
B. A transferability election under Section 6418, allowing a one-time cash sale to an unrelated taxpayer
C. A five-year carryback of the credit to obtain an immediate cash refund
D. Assignment of the credit directly onto each partner's individual personal return

56. Under the traditional (regular) research credit method of Section 41, the credit equals 20% of qualified research expenses exceeding a base amount, computed by multiplying current-year gross receipts by the taxpayer's fixed-base percentage. How is the fixed-base percentage generally determined for an established company, one that is not a qualified start-up?

A. A flat 3% rate applies to all established companies regardless of research history

B. It equals current-year qualified research expenses divided by current-year gross receipts

C. It is elected annually at the taxpayer's discretion, between 1% and 16%

D. Aggregate QREs for 1984-1988 divided by aggregate gross receipts for that period, capped at 16%

57. On July 1, 2025, Delta Energy Partners sold its entire working interest in an oil well to Apex Drilling mid-year. The well produced 10,000 barrels in the first half of the year while owned by Delta, and 8,000 barrels in the second half while owned by Apex. How should percentage depletion be allocated between the two owners for 2025?

A. Apex claims depletion on all 18,000 barrels since it owned the well at year-end

B. Delta claims depletion on all 18,000 barrels since it originally developed the well

C. The IRS allocates depletion 50/50 between the parties regardless of production timing

D. Each party computes depletion separately on the barrels produced while it held the economic interest

58. Dr. Yusuf purchased specialized diagnostic equipment for $60,000 and used it 70% for her medical practice and 30% for personal purposes throughout the entire recovery period, claiming depreciation only on the business-use portion. She sells the equipment in 2025 for $50,000, recognizing gain attributable to the business-use share. How does Section 1245 recapture apply?

A. Recapture applies to the full $50,000 sale price regardless of business-use percentage

B. No recapture applies at all because the asset was never used 100% for business

C. Recapture applies only to gain from the business-use portion, limited to depreciation claimed on it

D. Recapture applies only to the personal-use portion, since business depreciation is exempt from recapture

59. Summit Semiconductor Inc. places into service a new $10 million facility in 2025 used to manufacture semiconductors, qualifying under the CHIPS Act's Advanced Manufacturing Investment Credit. What credit rate applies to qualified investment in eligible semiconductor manufacturing property under Section 48D?

A. 25%

B. 10%

C. 30%

D. 6%

60. Renata is a licensed real estate agent earning $180,000 in commissions in 2025, above the QBI phase-out threshold. Her CPA is determining whether her real estate brokerage business is a specified service trade or business (SSTB) subject to full QBI phase-out. How does Section 199A treat real estate and insurance agents and brokers?

A. They are automatically SSTBs because they provide personal services to clients

B. They are specifically excluded from the SSTB definition, remaining eligible subject only to the wage/UBIA limitation

C. They are treated as SSTBs only if their commissions exceed $150,000

D. They are treated as SSTBs solely because their compensation is commission-based

61. Effective for tax years beginning after December 31, 2021, Section 174 requires taxpayers to capitalize and amortize research and experimental expenditures rather than deducting them currently. Over what period must domestic research expenditures generally be amortized?

A. 3 years, using a mid-year convention

B. 5 years, using a half-year convention

C. 7 years, using a mid-quarter convention

D. 15 years, using a half-year convention

62. Ironclad Manufacturing installs a certified pollution control facility at its existing plant in 2025 to reduce emissions from an existing production process. Assuming all Section 169 requirements are satisfied, over what period may Ironclad elect to amortize the facility's cost, in lieu of regular MACRS depreciation?

A. 36 months

B. 84 months

C. 60 months

D. 120 months

63. In 2025, Ferrante Realty replaces the roof on a nonresidential office building it owns and leases to tenants. Which statement correctly describes Section 179 expensing eligibility for this roof replacement?

A. Roofs are never eligible for Section 179 expensing because they are structural components

B. Roofs qualify only if bonus depreciation is also elected on the same property in the same year

C. Roofs qualify for Section 179 only when installed on residential rental property

D. Roofs on nonresidential real property qualify under a category specifically added by statute, along with HVAC, fire protection/alarm, and security systems

64. Ortiz Consulting converts a company vehicle, previously depreciated as 100% business-use Section 1245 property, entirely to the owner's personal use in 2025, with no sale or exchange occurring. What is the Section 1245 recapture consequence at the moment of conversion?

A. No recapture is triggered at conversion, because it is not a taxable disposition; recapture is deferred until an actual sale or exchange

B. Recapture is triggered immediately, taxed as ordinary income equal to all depreciation previously claimed

C. Recapture is triggered immediately but is instead taxed at long-term capital gains rates

D. Recapture is permanently avoided because personal-use property is never subject to Section 1245

65. Coastal Resort Hotels hires a 17-year-old resident of an empowerment zone as a summer youth employee, working from May through August 2025. Under the WOTC rules for this specific targeted group, which statement is correct?

A. The wage cap and credit rate are identical to those of the general WOTC targeted groups

B. Qualified first-year wages are capped at $3,000, lower than the $6,000 cap for most other WOTC groups

C. The credit is unavailable because seasonal summer employment never qualifies for WOTC purposes

D. The employee must work a minimum of 12 months to qualify under this targeted group

66. Meridian Logistics LLC misclassified 12 drivers as independent contractors for 2024 but timely filed Forms 1099-NEC reporting their compensation. Upon audit, the IRS reclassifies the drivers as employees. Meridian did not act with intentional disregard of the information-reporting requirements.

Under IRC Section 3509, what rate applies to Meridian's liability for federal income tax withholding on the reclassified wages?

A. The full statutory withholding rate, as if Meridian had properly withheld throughout the year

B. Zero, because filing Forms 1099-NEC fully exempts an employer from any withholding liability

C. A reduced rate of 3.0% of wages, doubled to 6.0% because the required returns were not filed

D. A reduced rate of 1.5% of wages, because the required Forms 1099-NEC were filed

67. Renata, a U.S. citizen employed by a U.S. parent company, is assigned to work in Germany for three years. The United States and Germany maintain a totalization agreement. The employer obtains a certificate of coverage for Renata before her assignment begins. Which country's social security system covers Renata's wages during this temporary assignment?

A. Germany, because host-country social security coverage always governs regardless of any totalization agreement in effect.

B. Both countries simultaneously, since totalization agreements require dual coverage for verification purposes each year.

C. The United States, since the assignment is five years or less and the coverage certificate exempts her from German insurance.

D. Neither country, because totalization agreements exempt assignees from social security taxation entirely during the assignment.

68. Under a group long-term disability plan, Bramwell Corp. pays 100% of the premiums for its employees and does not include the premium cost in employees' taxable wages. Employee Diego becomes disabled and begins receiving $3,200 per month in benefits under the policy. How are Diego's monthly disability benefits treated for federal income tax purposes?

A. Fully taxable to Diego as ordinary income, because the premiums were employer-paid and excluded from his wages

B. Fully tax-free, because disability benefits are always excluded from gross income under Section 104

C. Half taxable, because the IRS requires a fixed 50/50 allocation regardless of who paid the premiums

D. Tax-free only if Diego had been continuously employed for at least 10 years before becoming disabled

69. Priya is the sole shareholder-employee of an S corporation and maintains a home office used exclusively and regularly for the corporation's business. Because unreimbursed employee business expenses are no longer deductible on Schedule A after the TCJA, what is the correct way for Priya to obtain a tax benefit for her home-office costs?

A. The S corporation reimburses Priya under an accountable plan and deducts the reimbursement as a corporate business expense

B. Priya claims the simplified $5-per-square-foot method directly on her individual Schedule C

C. Priya files Form 8829 as an employee to claim the deduction against her W-2 wages

D. The home-office deduction is permanently unavailable to any S corporation shareholder-employee

70. Bramwell Consulting pays for reserved parking spaces at a nearby garage for its employees, at a cost of $280 per employee per month in 2025, below the monthly qualified transportation fringe exclusion limit. Under Section 274(l), enacted by the Tax Cuts and Jobs Act, how does Bramwell deduct this parking expense?

A. Bramwell may fully deduct the parking cost as an ordinary business expense, matching the employee's tax-free fringe benefit treatment.

B. Bramwell must capitalize the parking cost as a leasehold improvement rather than deducting it currently.

C. Bramwell generally may not deduct the cost of providing this qualified transportation fringe benefit, even though it remains tax-free to employees within the exclusion limit.

D. Bramwell may deduct only the portion of parking costs exceeding the monthly exclusion limit.

71. Oakhurst Consulting is headquartered in Texas, which imposes no state income tax. It hires Wanda, who works remotely full-time from her home in Oregon and never travels to Texas for work. What is Oakhurst's state income tax withholding obligation with respect to Wanda's wages?

A. Oakhurst withholds no state income tax, because its headquarters state imposes none

B. Oakhurst must register as an Oregon employer and withhold Oregon income tax, because withholding follows the state where the employee physically performs the work

C. Oakhurst may elect to withhold under either state's rules at its own discretion

D. Withholding is required only if Wanda visits the Texas office at least once per quarter

72. Continental Freight implements an electronic system allowing employees to complete and submit Form W-4 online instead of on paper. Which of the following requirements must this electronic system satisfy for the resulting withholding certificates to be valid under IRS rules?

A. The system may omit the required perjury statement as long as employees check an 'I agree' consent box.

B. The system must limit employees to submitting a new Form W-4 only once per calendar year.

C. The employer must mail the IRS a paper copy within 10 days of each electronic submission received.

D. The system must capture the paper form's data, provide an electronic signature under penalty of perjury, and match submitted data.

73. Hazel begins performing the same work at Client Co. through a non-certified, ordinary Professional Employer Organization (PEO) that is not a Certified Professional Employer Organization (CPEO). The PEO takes over payroll processing mid-year. Does Hazel's Social Security and Medicare wage base carry over from Client Co. to the PEO under Section 3511's successor-employer rules?

A. Yes, non-certified PEOs receive the identical statutory successor-employer wage-base carryover treatment given to CPEOs.

B. No, Section 3511's wage-base carryover applies only to CPEOs, so Hazel's FICA wage base generally restarts at zero.

C. No, wage-base carryover is never available to any third-party payer arrangement whatsoever, including CPEOs.

D. Yes, but only if Hazel's wages already exceed the Social Security wage base while at Client Co.

74. Under its benefits program, Delacroix Industries reimburses employees $20 per month for bicycle commuting expenses during 2025. How must Delacroix treat this reimbursement for federal tax purposes?

A. Fully excludable up to $20 per month as a qualified transportation fringe benefit under current law.

B. Excludable up to the combined transit-and-parking qualified transportation fringe cap for the year.

C. Fully taxable wages, because the TCJA suspended the bicycle commuting reimbursement exclusion for 2018 through 2025.

D. Excludable only for employees who also decline the employer's separate parking fringe benefit offer.

75. Thornwood Manufacturing offers employees a workplace wellness program. Employees who complete a biometric health screening receive a $150 cash reward, while employees who complete a smoking-cessation class receive a gym membership reimbursement of equal value. How are these two wellness incentives generally treated for federal tax purposes?

A. Both incentives are entirely tax-free, because wellness program rewards are excluded from wages regardless of form.

B. Both incentives are fully taxable wages, because employer wellness incentives are never excludable under any Code section.

C. The cash reward is tax-free as a de minimis fringe, while the gym reimbursement is fully taxable.

D. The $150 cash reward is taxable wages subject to withholding, while the gym reimbursement is not automatically excludable and depends on the specific medical-care nexus.

76. Reverend Callahan is a duly ordained minister performing ministerial services for First Community Church and has not filed an exemption request with the IRS. How is Reverend Callahan's ministerial compensation treated for federal employment tax purposes?

A. Ministerial compensation is exempt from church FICA withholding; the minister pays SECA on net earnings, absent an approved exemption.

B. The church must withhold FICA on ministerial compensation the same way it would for any ordinary lay employee.

C. Ministers are entirely exempt from both FICA and SECA taxation on all of their ministerial income.

D. The church may elect annually whether to treat the minister under FICA or under SECA instead.

77. Ridgeline Utility Co. provides a marked utility repair truck equipped with permanently mounted equipment to lineworker Tomas, who is not permitted any personal use beyond commuting to and from job sites. How are the substantiation and valuation rules applied to Tomas's use of the truck?

A. Tomas must maintain a mileage log meeting Section 274(d) strict substantiation requirements for all his vehicle use.

B. As a 'qualified nonpersonal use vehicle,' the truck is exempt from strict substantiation and valuation rules; commuting isn't taxable.

C. The employer must apply the cents-per-mile valuation method to all of Tomas's personal use of the truck.

D. The vehicle is treated identically to a standard passenger automobile under the Section 280F limitations.

78. Odette used a qualifying 220-square-foot home office in her first residence from January through June 2024, then sold that home and set up a new qualifying 180-square-foot home office in a second residence from July through December 2024. How is her home-office deduction computed under the simplified method for 2024?

A. The simplified method allows a separate calculation for each home, applying the $5-per-square-foot rate up to a 300-square-foot cap at each location, prorated for the months used

B. Odette must use the actual-expense method exclusively whenever more than one home office is used in the same year

C. Odette may claim the deduction only for whichever home office was used for the longer period

D. The simplified method prohibits any home-office deduction in a year involving a home sale

79. Quarry Ridge Landscaping has a clean three-year compliance history and deposited its first-quarter Form 941 payroll taxes four days late because of a one-time bookkeeping error, with no other compliance issues before or since. What penalty relief is most likely available to Quarry Ridge for this late deposit?

A. No relief is available; failure-to-deposit penalties are always strictly liable regardless of the taxpayer's compliance history.

B. Reasonable-cause relief is unavailable for payroll tax deposit penalties under any circumstance whatsoever.

C. Quarry Ridge may qualify for First-Time Abate relief, given its clean three-year history and this isolated instance.

D. Relief is available only if the deposit was made more than 30 days after its original due date.

80. Attorney Ellen Voss creates three separate irrevocable trusts for the same beneficiary, funding each with nearly identical stock portfolios, explaining that dividing the assets keeps each trust's income within a lower compressed tax bracket. Under Section 643(f), how will the IRS most likely treat these trusts?

A. As three separate taxpaying trusts, since each has its own trustee and a distinct trust instrument

B. As grantor trusts reportable on Ellen's individual return under the reversionary-interest attribution rules

C. As one complex trust, but only if all three trusts share a single trustee and bank account

D. As a single trust for tax purposes, since they share substantially the same grantor, beneficiary, and an avoidance purpose

81. Harold Feeney's son died in 2019, leaving Harold's 16-year-old granddaughter as his only descendant. In 2026, Harold makes a $50,000 outright gift to the granddaughter. For generation-skipping transfer tax purposes, how is this gift treated?

A. As a taxable direct skip, because the granddaughter is two generations below Harold under standard rules

B. As GST-exempt only if Harold also files a timely QTIP election on a gift tax return

C. As not a skip person transfer, since the predeceased-parent rule moves the granddaughter up one generation

D. As a taxable skip regardless, because generation assignment under Section 2651 ignores a parent's death entirely

82. The Voss Family Charitable Remainder Trust pays income to Denise Voss for life, with the remainder passing to a qualified charity at her death. The trust has amounts irrevocably dedicated to charitable purposes. For which purpose is this trust treated as a private foundation under Section 4947(a)(1)?

A. For income tax purposes only, requiring the trust to file Form 1041 as a complex trust

B. For purposes of the Chapter 42 private foundation excise taxes, such as self-dealing and jeopardizing investments, even though it is not itself tax-exempt

C. For estate tax purposes only, requiring inclusion of the entire trust corpus in Denise's gross estate

D. For gift tax purposes only, treating Denise's life income interest as a taxable gift each year

83. Meridian Tool Works wants its traditional 401(k) plan to satisfy the ADP/ACP safe harbor for the 2026 plan year using a safe-harbor matching contribution (not the QACA automatic-enrollment design). By what deadline must eligible employees receive the annual safe-harbor notice describing the contribution formula and plan rights?

A. A reasonable period before the start of the plan year, generally satisfied by providing the notice between 30 and 90 days before the plan year begins

B. No written notice is required at all if the employer uses a matching, rather than nonelective, safe-harbor formula

C. Within 90 days after the close of the plan year, along with the Form 5500 filing

D. At any time during the plan year, as long as it is provided before the last payroll of December

84. Patricia Nunes owns shares in a cooperative housing corporation and occupies an apartment under a proprietary lease. The corporation pays mortgage interest and real property taxes on the building. Under Section 216, how does Patricia treat her allocable share of these payments?

A. She may not deduct any share, because legal title to the building is held by the cooperative, not Patricia

B. She must add her allocable share of the interest and taxes to the basis of her cooperative shares

C. She may deduct her share only if the cooperative elects partnership taxation under Section 761

D. She may deduct her share of the interest and taxes directly, provided the Section 216 tenant-stockholder requirements are satisfied

85. The Osgood Family Trust, a complex trust, recognizes $40,000 of long-term capital gain during the year from the sale of securities. The trust instrument and applicable state law provide that capital gains are allocated to trust corpus (principal) rather than to income, and the trustee retains the gain rather than distributing it. How is the $40,000 gain treated in computing the trust's distributable net income (DNI)?

A. It is generally excluded from DNI and taxed to the trust, since corpus-allocated capital gains are ordinarily excluded from DNI

B. It is always included in DNI, because DNI includes every capital gain realized during the trust's tax year

C. It is excluded from DNI only if the trustee also elects out of the following year's 65-day rule

D. It is included in DNI and deemed automatically distributed under the tier system governing complex trusts

86. Wendell established a QTIP trust for his late wife Corinne, who has a mandatory annual income interest for life. During her lifetime, Corinne sells her income interest in the trust to her son for its actuarial value. What is the gift tax consequence under Section 2519?

A. No gift tax consequence occurs, since Corinne received full and adequate consideration for the income interest sold

B. Corinne is treated as making a taxable gift of the entire remaining QTIP property, less any consideration she actually received

C. The sale triggers estate tax inclusion of the trust under Section 2044, but no gift tax consequence arises

D. Only the actuarial value of the income interest itself is treated as a taxable gift under Section 2511

87. Riverside Charitable Trust, a tax-exempt organization, purchases an office building for $2,000,000, financing $1,200,000 (60%) with a mortgage and paying the remainder in cash. The trust leases the entire building to unrelated for-profit tenants and has no exception available. How is the rental income treated under the unrelated debt-financed income rules of Section 514?

A. All of the rental income is excluded from UBTI, because rents from real property are always excluded under Section 512(b)(3)

B. None of the income is UBTI, since real property acquisitions are never treated as debt-financed property

C. The entire rental income is UBTI, because any acquisition indebtedness converts 100% of the property's income to unrelated business income

D. 60% of the rental income and deductions is UBTI, matching acquisition indebtedness as a percentage of the property's average basis

88. Marcus, age 45, has a self-only High Deductible Health Plan and an HSA. He wants to make a one-time transfer directly from his traditional IRA to his HSA to fund it, under Section 408(d)(9). If his 2026 self-only HSA contribution limit is $4,300, what is the maximum amount he may transfer this way, and how many times may he do this in his lifetime?

A. Up to $4,300, and he may repeat the transfer every year without limit

B. There is no dollar limit, but the transfer may only be made once in his lifetime

C. Up to $4,300 (his annual HSA contribution limit), and generally only once in his lifetime

D. Up to half of $4,300, and he may repeat the transfer once every five years

89. Cascade REIT, a calendar-year real estate investment trust, reports $10,000,000 of REIT taxable income for 2026. To maintain its REIT status and avoid corporate-level tax on distributed income, what is the minimum amount Cascade generally must distribute to shareholders as dividends for the year?

A. 100% of REIT taxable income, since REITs, unlike regular corporations, may not retain any earnings
B. At least 90% of REIT taxable income (excluding net capital gain), or $9,000,000, though tax is still owed on any amount retained
C. At least 50% of REIT taxable income, matching the general dividends-paid deduction rules for C corporations
D. At least 95% of REIT taxable income, a requirement that was reduced to 90% only for regulated investment companies

90. The Kessler Trust's governing instrument requires all "income" to be distributed annually to the beneficiary, defining income under the applicable state's version of the Uniform Principal and Income Act. The trust earns $30,000 of dividends and interest and also has $12,000 allocated to principal for a portion of a unitrust-style adjustment. For determining what must actually be distributed to the income beneficiary, which figure controls?

A. Federal taxable income, since state law definitions of income are preempted for federal tax purposes
B. Distributable net income (DNI), because DNI defines the trustee's state-law distribution obligation
C. Fiduciary accounting income (FAI), as defined by the instrument and state law, which governs the trustee's actual distribution obligation
D. The lesser of DNI or FAI, applied automatically under the trust's default distribution formula

91. Donor Beatrice, age 72, funds a charitable remainder annuity trust (CRAT) with $500,000, retaining a fixed annuity of 7% ($35,000) per year for life, with the remainder to a qualified charity. Before the trust can qualify under Section 664, what actuarial test must it pass?

A. The 5% probability-of-exhaustion test, ensuring less than a 5% chance the trust corpus will be exhausted before the annuity term ends, using IRS actuarial tables
B. The 10% minimum remainder interest test only, with no separate exhaustion test required for annuity trusts
C. The 5% minimum annual payout test, requiring the annuity to equal at least 5% of the trust's value each year

D. The 50% probability test, requiring at least even odds that some remainder will pass to charity

92. Lakeside Yacht Club, a tax-exempt social club under Section 501(c)(7), earns $180,000 from member dues and activities and also earns $25,000 of interest and dividend income on its invested reserve funds. How is the $25,000 of investment income treated for tax purposes?

A. It is fully exempt, because Section 501(c)(7) clubs may earn unlimited passive investment income without tax consequence

B. It is entirely nonexempt-function income and disqualifies the club's exemption if it exceeds member dues

C. It is excluded from UBTI under the same passive-income exclusion available to public charities

D. It is generally treated as unrelated business taxable income, since investment income is not exempt-function income from members

93. Trevor, age 40, inherits a Roth IRA in 2026 from his uncle, who was not his spouse and does not qualify as an eligible designated beneficiary. The Roth IRA had been open for more than 5 years at the uncle's death. What distribution rule applies to Trevor, and are distributions taxable?

A. The 10-year rule applies (full distribution by the end of the 10th year after death), but qualified distributions from the inherited Roth IRA are income-tax-free since the 5-year holding period was already met

B. The 10-year rule applies, and all distributions are fully taxable as ordinary income to Trevor regardless of the account's holding period

C. Trevor may stretch distributions over his own life expectancy, since Roth IRAs are exempt from the SECURE Act's 10-year rule

D. No distributions are required until Trevor reaches age 73, mirroring the uniform lifetime table used for traditional IRAs

94. Farmer Iris Callahan enrolls 80 acres of her farmland in the USDA's Wetlands Reserve Easement Program, permanently retiring the land from crop production in exchange for a one-time easement payment of $240,000, while continuing to actively farm her remaining 300 acres. How does Iris generally report the easement payment?

A. As fully excludable income under the cost-share conservation payment exclusion available to all federal conservation program payments

B. As ordinary farm income reported entirely on Schedule F in the year received, since it replaces crop income

C. As proceeds from selling a perpetual easement, generally reducing the affected land's basis, with excess over basis taxed as capital gain

D. As a Section 1231 involuntary conversion, deferrable if reinvested in replacement farmland within two years

95. The Bramwell Estate pays $18,000 in executor fees and $6,000 in trust accounting fees during administration, costs that would not have been incurred if the property were held by an individual rather than in an estate. How are these costs treated on the estate's Form 1041?

A. They are miscellaneous itemized deductions, subject to the 2% AGI floor suspended only through 2025

B. They are fully deductible under Section 67(e), since they would not be incurred outside an estate, and escape the 2% floor

C. They are nondeductible personal expenses, since executor and accounting fees are inherently personal costs

D. They must be capitalized into the basis of the estate's remaining assets, not deducted currently

96. The Midstate Contractors Association is organized to promote common business interests of its member construction firms, such as advocating for industry standards, but does not itself engage in a regular business of a kind ordinarily carried on for profit, and no part of its net earnings benefits any private member. Under which section is it most appropriately exempt, and what is a key limitation?

A. Section 501(c)(3), as an educational organization, limited by the prohibition on any lobbying activity whatsoever

B. Section 501(c)(4), as a social welfare organization, limited to activities that primarily benefit the general public

C. Section 501(c)(7), as a social club, limited to no more than 15% nonmember income

D. Section 501(c)(6), as a business league, limited because it may not primarily perform services for individual members

97. Bramwell Corp's qualified profit-sharing plan receives an employer contribution for the year that exceeds the deductible limit under Section 404(a), creating a nondeductible excess contribution. If Bramwell does not correct the excess by the end of the following plan year, what excise tax applies under Section 4972?

A. A 50% excise tax imposed directly on the plan participants who received the excess allocation.

B. A 100% excise tax equal to the full amount of the employer's total contribution for the year.

C. A 10% excise tax on the amount of the nondeductible excess contribution, reported by the employer on Form 5330.

D. No excise tax applies as long as the plan otherwise remains qualified under Section 401(a).

98. Developer Ortiz Properties LLC placed a low-income housing project in service in 2020, claiming Low-Income Housing Tax Credits under Section 42 over a 10-year credit period, subject to a 15-year compliance period. In 2026, the project falls out of compliance and the qualified basis is reduced. What is the tax consequence?

A. No recapture applies once the credit period has fully closed, regardless of when noncompliance occurs

B. A portion of prior credits is recaptured, roughly the accelerated share tied to the basis drop, plus interest, since the project remains in its compliance period

C. The entire credit claimed over all prior years must be repaid in full, with no partial recapture mechanism available

D. Recapture applies only if the project is sold, not for compliance failures during the holding period

99. Trustee Naomi Cole administers a complex trust that will terminate and make its final distribution in 2026. The trust has been paying quarterly estimated tax payments. To avoid the trust overpaying estimated tax that a beneficiary could instead credit against the beneficiary's own liability, what election is available under Section 643(g)?

A. The trustee may elect to treat estimated payments as paid directly by the beneficiaries, who then claim them on their returns.

B. The trustee may request an automatic refund of all estimated payments upon filing the trust's final Form 1041.

C. The trustee may carry the estimated payments forward indefinitely as a credit against the trust's future income tax.

D. The trustee may reassign the estimated payments to the successor trustee of a newly created trust.

100. Horizon Advocacy Foundation, a 501(c)(3) public charity, wants clear, objective dollar limits on how much it can spend on lobbying without risking its tax-exempt status, rather than relying on the vague "no substantial part" facts-and-circumstances standard. What may it do?

A. Nothing; public charities may never engage in any lobbying activity under any circumstances

B. File Form 1023 again to convert to a 501(c)(4) organization, which has no lobbying limits at all

C. Rely on the insubstantial-part test exclusively, since no elective alternative exists for measuring lobbying activity

D. Make the Section 501(h) election on Form 5768, subjecting lobbying to defined expenditure-percentage limits instead

Answer Key and Explanations — Practice Exam 25, Part 2: Businesses

1. B — Under Section 6063 and Treasury regulations, any one partner, or an LLC member-manager, may sign Form 1065; unanimous consent or a designated managing partner is not required. A paid preparer signs only the preparer declaration and cannot substitute for a partner's signature. Choices A, C, and D impose restrictions the Code does not mandate.

2. A — Section 6698 imposes a monthly penalty computed by multiplying a per-partner dollar amount by the number of partners, for each month or part of a month the return is late, up to twelve months. Because partnerships are pass-through entities, the penalty applies regardless of whether any tax is actually owed. Choices B, C, and D misstate the computation.

3. C — Section 755 requires the Section 743(b) adjustment to be allocated among partnership assets using a residual, fair-market-value-based method resembling Section 1060, first between ordinary-income-producing property and capital assets, then among specific assets within each class based on relative appreciation. An arbitrary equal split, an all-goodwill allocation, or partner selection under choices A, B, and D is not permitted.

4. D — Section 707(a)(2)(A) and its regulations recharacterize an allocation and distribution that is fixed, tied closely to services performed, and lacks significant entrepreneurial risk as a disguised payment for services rather than a genuine distributive share. Aldous's arrangement is therefore treated as ordinary compensation income, not a partnership allocation, distinguishing it from choices A, B, and C.

5. B — Under Section 6234, a partnership may petition for readjustment of a Final Partnership Adjustment within ninety days of its issuance, filing in the Tax Court, the federal district court where the partnership's principal place of business is located, or the Court of Federal Claims. Choices A, C, and D describe review options the Code does not provide.

6. A — A calendar-year partnership's Form 1065 is originally due March 15. Filing Form 7004 by that date grants an automatic six-month extension, moving the due date to September 15, not the October 15 date applicable to individual Form 1040 extensions. Choices B, C, and D misstate either the extension length or the resulting date.

7. D — Section 704(e) permits a donee family member to be recognized as a partner for a capital interest in a capital-intensive business, but requires that the donor-partner first be allocated reasonable compensation for services rendered to the partnership. Only the residual income after that compensation may be divided according to capital ownership. Choices A, B, and C misstate the required adjustment.

8. C — Costs of promoting and marketing partnership interests, such as printing a private placement memorandum, are syndication expenditures under Section 709, not organizational expenditures. Syndication costs must be capitalized and can never be amortized or deducted, unlike organizational costs, which may be partially deducted and amortized over 180 months. Choices A, B, and D misapply the organizational-expenditure rules to syndication costs.

9. D — Section 1446(f) generally requires the transferee of a partnership interest to withhold 10% of the amount realized when the transferor is a foreign person and the partnership is engaged in a U.S. trade or business, unless an exception or certification applies. The buyer bears this obligation, not the partnership or Henrik.

10. C — Section 706(d) requires a partnership to account for a partner's varying interest during the year using either an interim closing of the books, which segregates actual income and expense into pre- and post-change periods, or a proration method based on days or another reasonable basis. Choices A, B, and D describe methods the Code does not permit.

11. A — Section 6222 generally requires a partner to treat partnership items consistently with the partnership's return. A partner who wishes to report an item differently must file Form 8082, Notice of Inconsistent Treatment, disclosing the discrepancy; silently reporting a different figure or waiting for partnership action is not permitted. Choices B, C, and D describe noncompliant approaches.

12. B — Reg. Section 1.704-2 permits special allocations of nonrecourse deductions to have substantial economic effect only if the agreement contains a minimum gain chargeback, requiring partners to be allocated income offsetting prior nonrecourse deductions in proportion to their share of minimum gain whenever it decreases. No guarantee or debt conversion is required.

13. B — A business bad debt owed to an accrual-basis taxpayer may be deducted as an ordinary loss for the portion that becomes partially worthless during the year, unlike a nonbusiness bad debt, which is deductible only as a short-term capital loss and only when wholly worthless. Choices A, C, and D misapply the nonbusiness bad debt rules to a business receivable.

14. C — The Additional Medicare Tax imposes an extra 0.9% on self-employment income above $200,000 for an unmarried taxpayer (thresholds vary by filing status), on top of the regular SE tax computed under Section 1401. No deduction is allowed for this additional 0.9% tax, and there is no employer-equivalent offset. Choices A, B, and D misstate the mechanics.

15. D — Section 3121(b)(3) exempts wages paid by a parent's sole proprietorship (or a partnership owned solely by the child's parents) to a child under age 18 from FICA tax; FUTA is exempt until age 21. This exemption does not apply if incorporated or if a non-parent co-owns the partnership. Choices A, B, and C misstate the exemption's scope.

16. A — The de minimis safe harbor under Reg. Section 1.263(a)-1(f) allows a taxpayer without an applicable financial statement to expense amounts up to $2,500 per invoice or item, provided the election is made annually and consistent book treatment exists. Taxpayers with an AFS may use a higher $5,000 threshold instead. Choices B, C, and D misstate the applicable dollar limits.

17. A — A casualty loss to business-use property is deductible in full as an ordinary loss, without the $100-per-event floor, the 10%-of-AGI reduction, or the federally-declared-disaster requirement that currently limits personal-use-property casualty losses. Renata may therefore deduct the entire $14,000 loss. Choices B, C, and D describe rules that apply only to personal-use casualty losses, not business property.

18. D — The Tax Cuts and Jobs Act limited Section 1031 like-kind exchange treatment to exchanges of real property held for business or investment use, eliminating deferral for exchanges of personal property such as vehicles or equipment. Owen must recognize gain on the truck trade in the year of exchange. Choices A, B, and C describe deferral options no longer available.

19. C — Section 1361(c)(2)(A)(iv) permits a voting trust meeting statutory requirements to be an S-corporation shareholder, with each trust beneficiary counted as a separate shareholder for the 100-shareholder limit. Ordinary trusts generally disqualify a corporation's S election, but a properly structured voting trust is a specific statutory exception, distinguishing it from grantor trusts, testamentary trusts, and other trust categories.

20. B — A foreign corporation is a 'qualified foreign corporation' eligible for reduced qualified dividend tax rates if it is eligible for benefits under a comprehensive U.S. income tax treaty, such as the U.S.-Norway treaty, even without U.S.-market stock trading; foreign stock readily tradable on an established U.S. market independently qualifies too. Priya's dividend qualifies through the treaty pathway.

21. C — Consolidated return regulations under §1502 require Parent's stock basis in Sub to be adjusted upward for Sub's income and downward for losses and distributions. When cumulative losses exceed basis, the excess is not disallowed but instead creates an excess loss account, functioning as negative basis that is triggered into income upon a disposition or deconsolidation event.

22. A — Section 338(h)(10) is available only when the purchaser is a corporation acquiring stock of a target that is a member of a consolidated group, an S corporation, or an affiliate. Because Nadia is an individual, she cannot use §338(h)(10); however, §336(e) permits an analogous deemed-asset-sale election regardless of whether the purchaser is corporate, individual, or a group of buyers.

23. B — Under §267(a)(2) and §267(b)/(c) attribution rules, an accrual-basis corporation may not deduct an expense owed to a related cash-basis payee (including a minor child of a controlling shareholder under family attribution) until the year the related party actually receives and reports the payment as income, matching the corporation's deduction to the payee's income inclusion.

24. D — Under §162(a)(1), a corporation may only deduct compensation that is reasonable for services actually rendered. The IRS may disallow the deduction for the unreasonable excess amount paid to a controlling shareholder-employee and recharacterize it as a nondeductible constructive dividend, taxable to the shareholder as dividend income rather than as deductible wages, since the excess reflects a return on stock ownership.

25. D — To waive family attribution under §302(c)(2) for a complete-termination redemption, the departing shareholder must retain no interest in the corporation other than as a creditor, must not acquire any such prohibited interest within 10 years (absent an exception), and must attach an agreement to the tax return notifying the IRS of any acquisition of a prohibited interest during that period.

26. C — Section 291(a)(1) requires a C corporation selling §1250 real property to treat 20% of the depreciation that would have been recaptured under §1245 as additional ordinary income. Since straight-line depreciation triggered no §1250 recapture, Ashford recognizes 20% of the full $100,000 depreciation, or $20,000, as ordinary income; the remainder is §1231 gain.

27. A — Section 197 requires acquired goodwill and most other intangible assets from a taxable asset acquisition to be amortized ratably over a fixed 15-year period, regardless of the asset's actual estimated useful life or book treatment. Pinegate therefore amortizes the $600,000 goodwill at $40,000 per year for tax purposes, distinct from any different amortization period used for financial-statement reporting.

28. B — Section 336(d)(2) disallows recognition of a built-in loss on liquidating distribution of property contributed to the corporation within two years before the plan of liquidation was adopted, presuming a tax-avoidance purpose absent clear evidence otherwise. This anti-stuffing rule applies even to pro-rata distributions, unlike §336(d)(1), which is limited to non-pro-rata distributions to related shareholders.

29. A — Section 453(g) prohibits installment-method reporting for gain on the sale of depreciable property between related parties as defined by §1239(b), which includes an individual and a corporation she controls (more than 50% ownership). Corliss must therefore recognize the entire $60,000 gain in the year of sale, unless she demonstrates the arrangement had no significant tax-avoidance purpose.

30. B — Section 267(d) lets a transferee offset later gain by the transferor's previously disallowed related-party loss under §267(a)(1), limited strictly to the amount of the realized gain. The corporation's $25,000 realized gain is fully absorbed by Marisol's $40,000 disallowed loss, so recognized gain equals zero; the unused $15,000 offset is permanently lost and cannot be carried forward to later years.

31. C — Under §1366(d)(1)-(2), a shareholder's pass-through loss exceeding stock and debt basis is not permanently lost but suspended and carried forward indefinitely. When Desmond's Year 3 capital contribution restores sufficient basis, the $12,000 suspended loss becomes deductible in that year as if currently incurred, still subject to any applicable at-risk and passive-activity loss limitations.

32. D — Section 355(e) treats a spin-off as part of a plan if 50% or more of Distributing or Controlled stock is acquired within two years under a plan connected to the distribution, presumed here from the pre-negotiated sale. Distributing Corp recognizes corporate-level gain as if it sold the Controlled stock at fair market value, though shareholders retain tax-free §355 treatment.

33. B — Section 7704 treats a publicly traded partnership as a corporation for tax purposes unless at least 90% of its gross income is qualifying passive-type income such as interest, dividends, real property rents, and certain natural resource income. Vantar LP's income is only 60% qualifying, so it fails the exception and is taxed as a corporation despite its partnership form.

34. C — Absent an election, §1377(a)(1) allocates an S corporation's income or loss to shareholders on a per-share-per-day basis, splitting the year between Foster's estate and the surviving shareholder based on ownership periods. If all affected shareholders consent, §1377(a)(2) instead permits a closing-of-the-books election, treating the year as two separate periods and allocating actual income based on when it was earned.

35. D — Continuity of Business Enterprise, a regulatory requirement independent of continuity-of-shareholder-interest, requires the acquiring corporation to either continue the target's historic business or use a significant portion of the target's historic business assets in a business after the reorganization. If Acquiring fails to satisfy COBE, the transaction is disqualified as a tax-free reorganization regardless of state-law merger validity.

36. A — Under Section 483 (or Section 1274 for larger contracts), a deferred-payment sale lacking adequate stated interest requires the parties to impute interest using the applicable federal rate, converting part of each payment into ordinary interest income and expense rather than sale proceeds. There is no arm's-length exception, and no $500,000 threshold determines whether imputation applies.

37. C — Section 1259 treats a taxpayer who enters an offsetting short sale against an appreciated financial position, such as a short sale against the box, as having constructively sold that position, triggering immediate gain recognition equal to fair market value minus basis. Deferral until delivery, recognizing a loss, and disregarding the transaction entirely are all incorrect.

38. B — Section 172(b)(1)(D) preserves a 2-year carryback for net operating losses attributable to farming businesses even though the Tax Cuts and Jobs Act eliminated carrybacks for most other post-2017 losses. The taxpayer may elect to forgo the carryback and instead carry the loss forward. A blanket no-carryback rule, a 5-year period, and a 10-year disaster period are all incorrect.

39. A — Section 1341 lets a taxpayer who repays claim-of-right income compare two results: the tax decrease from deducting the repayment in the current year, versus the tax decrease that would have occurred had the income been excluded in the earlier year, and use whichever produces the greater benefit. Simple current-year deduction alone, mandatory amendment, and NOL carryforward are incorrect.

40. D — Section 453A imposes an interest charge on the deferred tax liability attributable to installment obligations from sales over $150,000 (non-dealer property) when a taxpayer's total outstanding obligations exceed $5 million, applied only to the excess. It does not force immediate gain recognition, retroactively disqualify installment reporting, or exempt this building merely because it is not dealer property.

41. B — A home-construction contract, one where 80% or more of estimated costs relate to dwelling units, qualifies for the completed-contract method regardless of the contractor's gross-receipts size under Section 460(e)(6). The general small-contractor exception requiring gross receipts under a set threshold applies only to non-home-construction long-term contracts, so Bramstead's $28 million in receipts does not disqualify it here.

42. D — The Section 197 anti-churning rules bar amortization when a taxpayer acquires an intangible from a related party who held it before the intangible became eligible for amortization (generally August 1993) and did not amortize it. Because the goodwill was held by a related brother since 1990, Delacroix cannot amortize it at all.

43. C — Section 163(j)(1) and 163(j)(9) exclude floor-plan financing interest for dealers of motor vehicles, boats, and farm equipment from the business interest limitation entirely, so it remains fully deductible. The tradeoff is that a dealership electing this exclusion loses eligibility for 100% bonus depreciation on property used in that trade or business. The other choices misstate this exception.

44. A — A properly identified hedging transaction under Section 1221(b)(2) and Reg. Section 1.446-4 produces ordinary gain or loss, not capital gain or loss, and the timing of that gain or loss is generally matched to the hedged item's income or expense recognition. Proper hedge identification also removes the transaction from the Section 1256 mark-to-market regime, and no tax-exempt treatment applies here.

45. C — Section 1244 allows ordinary-loss treatment for worthless or sold qualifying small business stock, capped annually at $50,000 for single filers ($100,000 for married filing jointly), regardless of the corporation's total capitalization. Any loss beyond that cap retains capital-loss character. Okafor's $80,000 loss therefore splits into $50,000 ordinary and $30,000 capital, not fully ordinary or fully capital.

46. B — Under Section 1233, the character of gain on a short sale is generally determined by the holding period of the substantially identical property used to close the short position, not by how long the short position itself was open. Because Callum's closing shares were held only briefly before delivery, the gain is short-term, not automatically long-term or ordinary income.

47. D — Section 165(g)(3) allows a corporate shareholder to treat the worthlessness of stock in a qualifying affiliated subsidiary (at least 80% owned, with 90% or more of gross receipts from active sources) as an ordinary loss rather than a capital loss, reflecting the character of the underlying business. A capital-loss characterization, a short-term classification, or a mixed-character split is incorrect.

48. A — Section 1231(b)(4) allows an unharvested crop sold together with the underlying land, to the same buyer in the same transaction, to be treated as Section 1231 property, provided the land itself satisfies the Section 1231 holding-period requirement. This lets the crop share in the land's favorable capital-gain-with-ordinary-loss treatment rather than being taxed separately as ordinary inventory income.

49. D — Section 1253 provides that when a franchisor transfers a franchise but retains significant power, right, or continuing interest, such as approval rights over assignments or quality-standard controls, the gain is ordinary income rather than capital gain, because the transfer is not treated as a sale of a capital asset. The other answers misapply capital-gain, Section 1231, or exchange rules.

50. A — Section 1017 requires that when excluded cancellation-of-debt income is applied to reduce tax attributes via basis reduction, the taxpayer's basis in the designated depreciable property is reduced, which in turn lowers future depreciation deductions and increases gain (or reduces loss) on a later disposition. Basis is reduced, not increased, and the exclusion is not negated by making the election.

51. B — The Inflation Reduction Act added an energy community bonus credit, providing an additional 10 percentage points atop the base Section 48 investment tax credit rate for facilities sited in a qualifying energy community, such as a brownfield site or an area with historical fossil-fuel employment. Solaris Grid's 30% rate rises to 40%.

52. C — For real property placed in service before 1987 and depreciated under an accelerated ACRS method, Section 1250 requires ordinary income recapture of additional depreciation, the excess of accelerated depreciation over what straight-line would have produced. This $40,000 excess is taxed as ordinary income, while the remaining gain is capital. Post-1986 straight-line-only property generally has no such ordinary recapture.

53. A — Section 179(c)(2) allows a taxpayer to revoke a prior Section 179 election without obtaining IRS consent, simply by filing an amended return for the election year, a rule effective since 2003. No private letter ruling is needed, the election is not irrevocable, and revocation is never conditioned on selling the property within the same tax year.

54. C — The 2017 Tax Cuts and Jobs Act's drafting error left qualified improvement property without an assigned recovery period, defaulting it to 39 years and excluding it from bonus depreciation. The 2020 CARES Act retroactively corrected this glitch, assigning QIP a 15-year MACRS recovery period effective for property placed in service after 2017, restoring full bonus depreciation eligibility.

55. B — Section 6418, enacted by the Inflation Reduction Act, permits an eligible taxable entity to make a one-time election to transfer certain credits, including the Section 48 investment credit, to an unrelated taxpayer for cash. Direct pay under Section 6417 is generally limited to tax-exempt and governmental entities; Meridian, a taxable partnership, must instead use the transferability election.

56. D — Section 41(c)(3) defines the fixed-base percentage for established companies as aggregate qualified research expenses divided by aggregate gross receipts for tax years 1984 through 1988, rounded to the nearest hundredth of a percent and capped at 16 percent. Start-up companies instead use a statutory 3 percent fixed-base percentage during their first five credit years, not established companies.

57. D — Percentage depletion under Section 611 is allowed to each holder of an economic interest in a mineral property based on production occurring during that party's period of ownership. Delta computes depletion on the 10,000 barrels produced before the sale, and Apex computes depletion separately on the 8,000 barrels produced afterward; depletion is not assigned solely by year-end ownership status.

58. C — Section 1245 recapture applies only to the business-use portion of a mixed-use asset and only up to depreciation actually claimed on that portion. Because Dr. Yusuf depreciated just the 70 percent business-use share, recapture is limited to gain and depreciation tied to that share; the personal-use portion generated no depreciation deductions and therefore produces no recapture at all.

59. A — Section 48D, enacted by the CHIPS Act of 2022, provides a 25 percent investment tax credit for qualified investment in facilities that manufacture semiconductors or semiconductor manufacturing equipment. This differs from the Section 45X production credit, which pays per unit produced, and from the general 30 percent Section 48 energy credit rate, which does not apply here.

60. B — Treasury regulations under Section 199A specifically exclude real estate agents and brokers, along with insurance agents and brokers, from the SSTB definition, even though they render services for clients. Above-threshold taxpayers in these fields remain eligible for the QBI deduction, subject only to the wage and UBIA limitation, not the SSTB phase-out applying to enumerated service fields.

61. B — Under Section 174 as amended by the Tax Cuts and Jobs Act, effective for tax years beginning after 2021, domestic research and experimental expenditures must be capitalized and amortized ratably over five years using a half-year convention; foreign research expenditures instead require fifteen-year amortization. This capitalization rule is entirely separate from the Section 41 research credit computation.

62. C — Section 169 permits a taxpayer to elect rapid 60-month, or five-year, straight-line amortization for the cost of a certified pollution control facility added to an existing plant, in lieu of ordinary MACRS depreciation, provided state certifying authority and EPA requirements are satisfied. This election accelerates cost recovery well beyond what standard MACRS depreciation would otherwise allow.

63. D — Section 179(e), added by the PATH Act and expanded by the Tax Cuts and Jobs Act, specifically permits Section 179 expensing for roofs, HVAC units, fire protection and alarm systems, and security systems installed on nonresidential real property. This is a distinct statutory category apart from qualified improvement property and does not require bonus depreciation to be elected too.

64. A — Section 1245 recapture applies only upon a disposition of the property, such as a sale or exchange, and converting business property to personal use is not treated as a disposition. No gain, loss, or recapture is recognized at the moment of conversion. Any recapture is instead deferred until Ortiz actually sells or exchanges the vehicle in a later year.

65. B — The WOTC qualified summer youth employee targeted group covers 16- or 17-year-olds who reside in an empowerment zone and work for the employer between May 1 and September 15. Unlike most WOTC targeted groups, which carry a $6,000 qualified first-year wage cap, this group's wage cap is limited to $3,000, reflecting its shorter seasonal employment period.

66. D — Under IRC Section 3509(a), an employer that misclassifies workers without intentional disregard of the reporting rules, but timely files the required Forms 1099-NEC, owes income tax withholding at a reduced rate of 1.5% of wages rather than full statutory rates. Failure to file the returns doubles the rate to 3.0%. The other options misstate this reduced-rate schedule.

67. C — Under a U.S. totalization agreement, an employee assigned abroad for five years or less remains covered solely by U.S. Social Security if the employer obtains a certificate of coverage, avoiding dual taxation. Germany's system does not apply during this exempt period. Options A, B, and D misstate the coverage rule, which prevents double coverage rather than eliminating it entirely.

68. A — When an employer pays disability insurance premiums and does not include the premium in the employee's taxable wages, any benefits later received under the policy are fully taxable to the employee as ordinary income under Section 105. Tax-free treatment under Section 104 applies only when the employee pays premiums with after-tax dollars. B, C, and D misstate this rule.

69. A — An S corporation shareholder-employee cannot deduct unreimbursed home-office expenses on Schedule A after the TCJA suspended miscellaneous itemized deductions, and Schedule C/Form 8829 do not apply to W-2 wages. The proper approach is an accountable-plan reimbursement from the corporation, which deducts the reimbursed amount as a business expense while it remains tax-free to the shareholder-employee.

70. C — Section 274(l), added by the Tax Cuts and Jobs Act, generally disallows an employer's deduction for the cost of providing qualified transportation fringe benefits, including employee parking, even though the benefit remains excludable from the employee's income within the statutory monthly limit. This decouples the employer's deduction from the employee's tax-free treatment, unlike the earlier symmetric pre-TCJA rule.

71. B — State income tax withholding generally follows the state where the employee physically performs services, not the employer's headquarters state. Because Wanda works entirely from her Oregon home, Oakhurst must register as an Oregon employer and withhold Oregon income tax, regardless of Texas having no state income tax of its own. Options A, C, and D misapply the sourcing rule.

72. D — An electronic Form W-4 system is valid only if it captures the same data elements as the paper form, requires the employee to electronically sign under penalty of perjury, and ensures the transmitted data matches what the employee submitted. There is no requirement to mail paper copies to the IRS or to limit submissions to once annually.

73. B — Section 3511's successor-employer FICA wage-base carryover and joint-and-several liability framework apply specifically to Certified Professional Employer Organizations that have completed IRS certification. A non-certified, ordinary PEO does not qualify for this treatment, so Hazel's Social Security and Medicare wage base generally restarts at zero when the non-certified PEO begins processing her payroll.

74. C — The Tax Cuts and Jobs Act suspended the Section 132(f)(5)(F) qualified bicycle commuting reimbursement exclusion for tax years 2018 through 2025. Any amount an employer reimburses for bicycle commuting during this period is fully taxable wages subject to income and employment tax withholding, unlike the still-excludable transit and parking components of qualified transportation fringe benefits.

75. D — Cash or cash-equivalent wellness incentives are taxable wages subject to income and employment tax withholding, since cash is never excludable as a de minimis fringe regardless of amount. Noncash incentives, like the gym reimbursement, are not automatically tax-free either and require an independent exclusion basis, such as a genuine medical-care nexus, to be excludable.

76. A — Compensation paid to a duly ordained minister for ministerial services is exempt from FICA withholding by the employing church; the minister instead reports net ministerial earnings and pays self-employment tax under SECA, unless the minister has filed and received an approved Form 4361 exemption. Churches cannot elect FICA treatment for ministers, and full exemption from both systems is incorrect.

77. B — A marked utility truck with permanently mounted specialized equipment qualifies as a 'qualified nonpersonal use vehicle' under Section 274(d) regulations, which is exempt from the strict substantiation rules and the personal-use valuation methods otherwise required for employer-provided vehicles. Commuting in such a vehicle is not treated as taxable personal use, unlike standard passenger automobiles under Section 280F.

78. A — When a taxpayer maintains two qualifying home offices during the same year because of a move, the simplified method permits a separate calculation for each home: the $5-per-square-foot rate applies up to 300 square feet at each location, prorated for the months of use at each residence. Total deduction combines both periods rather than choosing only one home.

79. C — The IRS's First-Time Abate administrative waiver applies to failure-to-deposit and similar penalties when the taxpayer has a clean three-year compliance history, has filed (or filed extensions for) all currently required returns, and has paid or arranged to pay any tax due. Quarry Ridge's isolated four-day-late deposit fits this profile, making FTA relief available despite no formal reasonable-cause showing.

80. D — Section 643(f) authorizes the IRS to treat two or more trusts as one if they have substantially the same grantor(s) and primary beneficiary(ies) and a principal purpose of the multiple-trust structure is federal income tax avoidance, such as multiplying compressed trust brackets; spouses are treated as one grantor for this test.

81. C — Section 2651(e), the predeceased-parent rule, moves a grandchild up one generation to the parent's generation when that parent (the transferor's child) is deceased at the time of transfer, so the gift is treated as if made to a child, not a skip person, and GST tax does not apply, though the outright gift uses Harold's annual exclusion and lifetime exemption.

82. B — Under Section 4947(a)(1), a nonexempt split-interest trust with amounts irrevocably dedicated to charity, such as a charitable remainder trust, is treated as a private foundation for purposes of most Chapter 42 excise taxes (self-dealing, jeopardizing investments, taxable expenditures), even though the trust itself is not a tax-exempt organization and continues filing its own income tax return.

83. A — A traditional (non-QACA) safe-harbor 401(k) plan must give eligible employees an annual notice describing the safe-harbor contribution formula, plan rights, and election procedures within a reasonable period before each plan year begins; this is deemed satisfied if furnished no earlier than 90 days and no later than 30 days before the plan year starts.

84. D — Section 216 allows a tenant-stockholder in a qualifying cooperative housing corporation to deduct her proportionate share of the corporation's mortgage interest and real property taxes directly on her own return, as though she paid them personally, provided the cooperative meets the 80% tenant-stockholder income and stock-ownership tests defining a cooperative housing corporation.

85. A — Under Section 643(a)(3), capital gains are generally excluded from DNI and taxed to the trust or estate itself, because DNI is meant to reflect ordinary distributable income; gains allocated to corpus under the governing instrument or state law, and not paid, credited, or required to be distributed, are the classic case where this exclusion applies.

86. B — Section 2519 treats any disposition of all or part of a qualifying income interest in QTIP property as a deemed transfer of the entire remaining trust corpus, not merely the income interest, because the surviving spouse is treated as owning the whole property for transfer-tax purposes; consideration received reduces the taxable gift, but does not eliminate it.

87. D — Section 514 overrides the normal Section 512(b)(3) exclusion for rents when property is debt-financed; the percentage of income (and related deductions) treated as unrelated business taxable income equals the average acquisition indebtedness divided by the average adjusted basis of the property, here 60%, since no exception (such as the neighborhood land or qualified pension trust exceptions) applies.

88. C — A qualified HSA funding distribution under Section 408(d)(9) allows a one-time, direct trustee-to-trustee transfer from a traditional IRA to an HSA, capped at the individual's maximum annual HSA contribution limit for the year (here $4,300), and it counts toward that limit; generally, only one such transfer is permitted during the taxpayer's lifetime, absent a later HDHP-coverage change permitting another.

89. B — Section 857 requires a REIT to distribute at least 90% of its REIT taxable income (excluding net capital gain and computed without the dividends-paid deduction) to maintain REIT status, so Cascade must distribute at least $9,000,000; corporate-level tax still applies to any taxable income retained beyond amounts actually distributed to shareholders during the year or within permitted grace periods.

90. C — Fiduciary accounting income (FAI), governed by the trust instrument and state principal-and-income law, determines what the trustee is legally obligated to distribute to an income beneficiary. DNI is a separate federal tax concept that caps the income distribution deduction and characterizes what beneficiaries report; the two figures often differ and serve separate state-law and federal-tax purposes.

91. A — A CRAT must satisfy Rev. Rul. 77-374's 5% probability-of-exhaustion test: using the Section 7520 actuarial tables, there must be less than a 5% chance the trust's principal will be exhausted by annuity payments before the last measuring life ends (or term expires), in addition to separately satisfying the 10% minimum present-value remainder interest requirement of Section 664(d)(1)(D).

92. D — Unlike public charities, a Section 501(c)(7) social club's exemption is limited to income from members for pleasure, recreation, and social purposes; investment income such as interest and dividends is nonmember income and is generally taxed as unrelated business taxable income, even though it does not itself jeopardize exemption unless nonmember and investment income together exceed the 35%-of-gross-receipts limit.

93. A — As a non-spouse beneficiary who is not an eligible designated beneficiary, Trevor is subject to the SECURE Act's 10-year rule and must fully distribute the inherited Roth IRA by the end of the tenth year after death; no annual RMDs are required within that window, and because the 5-year Roth holding period was already satisfied, qualified distributions remain entirely income-tax-free.

94. C — A payment for a perpetual conservation easement that permanently restricts land use is treated as a sale or exchange of a property interest, not ordinary farm income; it first reduces the basis allocable to the easement-encumbered acreage, and only the amount received in excess of that basis is recognized as capital gain, typically long-term.

95. B — Section 67(e) allows an estate or trust to deduct costs paid in connection with its administration above the line, without regard to the 2% miscellaneous-itemized-deduction floor (which the TCJA otherwise suspended through 2025), provided the expenses would not commonly be incurred if the property were held by an individual outside a trust or estate, such as executor and accounting fees.

96. D — A business league exempt under Section 501(c)(6) must promote the common business interests of an industry generally, not itself carry on a business ordinarily conducted for profit, and not inure to individual members; its exemption is jeopardized if it primarily performs particular services for individual members rather than the trade as a whole.

97. C — Section 4972 imposes a 10% excise tax on an employer's nondeductible contributions to a qualified plan, reported and paid by the employer on Form 5330, unless the excess is timely withdrawn or corrected. This excise falls on the employer, not participants, and is not avoided merely because the plan remains qualified.

98. B — Section 42(j) imposes recapture when qualified basis is reduced during the 15-year compliance period; the recapture amount equals the accelerated portion of credits claimed in prior years attributable to the reduction (roughly one-third of the credit taken on the affected basis), plus interest, even though the credit itself is claimed ratably over only a 10-year credit period.

99. A — Section 643(g) allows the trustee of an estate or trust in its final tax year to elect to treat any portion of its estimated tax payments as having been made directly by a beneficiary, who then reports and credits that amount on his or her own return, avoiding a mismatch where the trust would otherwise overpay tax it cannot use.

100. D — Section 501(h) allows an eligible public charity to elect, by filing Form 5768, to measure permissible lobbying against objective expenditure limits tied to a sliding-scale percentage of exempt-purpose expenditures (with a separate, lower cap on grassroots lobbying), replacing the vague "no substantial part" facts-and-circumstances test with bright-line dollar thresholds and excise-tax consequences for exceeding them.