PRACTICE EXAM 26: 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. Wendell Cho, a cash-method sole proprietor IT consultant, receives a $9,000 advance retainer in November from a client for consulting services to be performed continuously through the following April. How must Wendell report this payment on Schedule C for the year received?

A. Recognize the $9,000 only as services are performed, deferring the unearned portion to next year, consistent with accrual-method deferral rules
B. Recognize none of the $9,000 until the engagement concludes, since the fee remains refundable if services are never completed
C. Recognize half of the $9,000 in the current year and half next year, matching the retainer to each tax year the work spans
D. Recognize the entire $9,000 in the current year, since cash-method taxpayers report income when received regardless of when services are performed

2. Sandra Okafor, a sole proprietor bookkeeper, is named executor of her uncle's estate, a one-time role unrelated to her regular occupation, and receives an $8,000 executor fee. How should Sandra treat this fee?

A. Report it on Schedule C as self-employment income subject to SE tax, since any fee for personal services is automatically self-employment income

B. Report it as other income on Schedule 1, not subject to self-employment tax, since a one-time fiduciary role is not her trade or business

C. Report it on her existing Schedule C alongside her bookkeeping revenue, since both activities involve providing services for compensation

D. Exclude it from gross income entirely, because fees paid to family members serving as fiduciaries are treated as nontaxable gifts

3. Lucas Bettencourt, a sole proprietor marketing consultant, converts a spare room into a home office meeting the exclusive-and-regular-use test beginning September 1; before that date the room was a personal guest room. For the current-year home office deduction, how must Lucas compute the amount?

A. Claim the full-year deduction, since the exclusive-and-regular-use test only examines how the space is used on the last day of the tax year

B. Claim no deduction for the current year, since a room must qualify for the entire tax year before any home office deduction is allowed

C. Claim a deduction prorated for the four months, September through December, that the space actually met the exclusive-and-regular-use requirement

D. Claim the full-year deduction under the simplified method only, since its flat rate already accounts for any partial-year qualification

4. Partner Elin Voss contributes her own unsecured $50,000 promissory note, payable over five years, to Cinderfield Partners in exchange for a partnership interest, contributing no cash or other property at formation. What is the immediate effect on Elin's outside basis under Section 721?

A. Elin's outside basis is not increased by the note's face amount; basis increases only as she actually makes principal payments on the note

B. Elin's outside basis immediately increases by the full $50,000 face amount, since a promissory note is property eligible for nonrecognition under Section 721

C. Elin's outside basis increases by $50,000 but is immediately reduced to zero, since unfunded notes are treated as recourse partnership liabilities

D. Elin's outside basis increases only by the note's fair market value, discounted for the time value of money over its five-year term

5. Wilhelmina Draycott is the sole general partner of Wrenholt Ventures Partners, which carries $80,000 of recourse debt for which the limited partners bear no economic risk of loss whatsoever. How is this $80,000 recourse liability allocated among the partners' outside bases under Section 752?

A. Entirely to Wilhelmina, since she alone bears the economic risk of loss for the recourse liability

B. Equally among all partners, regardless of who actually bears the economic risk of loss

C. Proportionally to each partner's capital contribution, regardless of liability exposure

D. Entirely to the limited partners, since general partners already have unlimited personal liability

6. Instead of paying cash, Brackenridge Partners satisfies a $40,000 guaranteed payment owed to Partner Ingrid Solheim for management services by transferring a parcel of investment land with a $40,000 fair market value and a $15,000 adjusted basis. What is the tax consequence to the partnership?

A. The partnership recognizes no gain, since guaranteed payments made in property are treated identically to ordinary nonliquidating distributions under Section 731

B. The partnership recognizes no gain, because guaranteed payments are deductible business expenses and property used to satisfy them never triggers gain

C. The partnership recognizes a $25,000 gain, because satisfying a guaranteed payment with appreciated property is treated as a taxable exchange, not a distribution

D. The partnership recognizes a $25,000 loss, since it effectively purchased services worth $40,000 by transferring property with only $15,000 of basis

7. Wrenmoor & Ashdale Partners has no Section 754 election in effect. When Partner Ossian Marchbanks sells his partnership interest to an incoming partner, the incoming partner's share of the partnership's adjusted basis in its assets exceeds their fair market value by $310,000, exceeding the substantial built-in loss threshold. What is the effect on the partnership despite the absence of a Section 754 election?

A. No basis adjustment applies, since only a valid Section 754 election can ever trigger a basis adjustment upon a transfer

B. The partnership must nonetheless make a mandatory basis adjustment under Section 743(d) because the built-in loss exceeds the $250,000 threshold

C. The transfer is voided entirely, since sales of a partnership interest are prohibited whenever a substantial built-in loss exists

D. The incoming partner may voluntarily choose whether to apply the adjustment, regardless of the dollar threshold involved

8. Partner Yusra Nabors sells her entire interest in Fenwick Machining Partners, which owns fully depreciated manufacturing equipment carrying substantial Section 1245 depreciation recapture potential, with no billed accounts receivable and no inventory. Does the equipment's recapture potential affect the character of Yusra's gain under Section 751?

A. No, because Section 751 hot-asset treatment applies only to unrealized receivables from services and substantially appreciated inventory, never to depreciable equipment

B. No, because depreciation recapture is recognized only when the partnership itself later sells the equipment, not when a partner sells her interest

C. Yes, but only if the partnership has formally elected to treat depreciable property as a hot asset for purposes of this particular sale

D. Yes, because Section 751(c) defines unrealized receivables to include recapture potential in depreciable property, converting that portion of Yusra's gain to ordinary income

9. Ottervale Partners wants to make a valid Section 754 election effective for the current year, in which a partner sold her interest to an incoming partner. What must the partnership do, and what is the effect once the election is made?

A. Attach a written statement to a timely filed return, including extensions, for the transfer year; the election then applies to all future transfers until validly revoked

B. File a separate standalone election form with the IRS within 90 days after the transfer date, applying only to basis adjustments from that specific transfer

C. Obtain unanimous partner consent and file the election with the following year's return, applying prospectively only to transfers occurring after that filing date

D. Simply begin computing basis adjustments on future Schedule K-1s, since Section 754 elections apply automatically once any partnership interest transfer occurs

10. Driscoll & Pryce Partners' agreement specially allocates a deduction to Partner Beatrix Callahan, but the allocation lacks substantial economic effect because the agreement fails to maintain capital accounts properly. How must this deduction instead be allocated among the partners?

A. Equally among all partners regardless of capital contributions, since a defective special allocation defaults automatically to a per-capita split

B. Entirely to the partner with the largest outside basis, since that partner is best positioned to absorb the deduction without limitation

C. According to the general profit-sharing ratios stated in the original, defective allocation provision, since those percentages still control absent a better standard

D. According to each partner's interest in the partnership, determined by all facts and circumstances, including contributions and rights to profits and liquidation proceeds

11. Larkhaven Partners ceases all business activity and completely winds up its affairs on June 10, triggering termination under Section 708(b)(1), with no partner continuing any business as a partnership afterward. By what date must Larkhaven file its final, short-period Form 1065?

A. April 15 of the following calendar year, the due date that would apply had the partnership continued operating for the entire year

B. September 15, the 15th day of the third month following the June termination date, absent a timely filed extension

C. December 10, six months after termination, matching the extended due date automatically available to all short-period partnership returns

D. June 30, the last day of the month termination occurred, since short-period returns are always due at month-end

12. Emmeline Faircross places a 25% capital interest in Silverwood Farms Partnership, a capital-intensive family business, into a properly established custodial account for her minor son, Julian, naming her brother Desmond Ashby, an independent adult, as custodian. Desmond exercises genuine, independent fiduciary judgment and is not controlled by Emmeline. How will the IRS most likely treat Julian's interest?

A. Disregarded entirely, because a minor can never be recognized as the real owner of a partnership interest under any custodial arrangement

B. Disregarded, because only a court-appointed guardian, never a custodian under a state transfers-to-minors statute, can satisfy the real-ownership requirement

C. Respected as a valid capital interest, because Desmond's independent, genuine fiduciary control establishes Julian as the real owner despite his minority

D. Respected only if Julian personally performs services for Silverwood Farms Partnership equal in value to his 25% capital allocation

13. Partner Chidi Iwu has $6,000 of outside basis, $4,000 of amount at risk, and is not a material participant in Halloway Creek Partners' rental activity, which allocates him a $9,000 loss for the year. In what sequence must the basis, at-risk, and passive activity limitations apply to determine how much Chidi may currently deduct?

A. Passive activity limits apply first, then at-risk, then basis, since the broadest limitation is intended to be tested before the narrower ones
B. At-risk limits apply first, then passive activity limits, then basis, since at-risk amounts are always the most restrictive of the three tests
C. All three limitations apply simultaneously to the $9,000 loss, and Chidi may deduct whichever result proves most favorable to him
D. Basis limits apply first, then at-risk limits, then passive activity limits, each successive test applied only to the amount surviving the prior one

14. Partner Astrid Sorensen holds both a general partner interest and a separate limited partner interest in Hollowbrook Partners, a single partnership. She devotes 180 hours to the business during the year, satisfying one standard material participation test other than the 500-hour test. Because she also holds a limited interest, is Astrid restricted to the tests available to limited partners?

A. No, holding both a general and limited partner interest in one partnership permits use of any material participation test, not only the limited-partner tests
B. Yes, holding any limited partner interest restricts an individual to the three narrow tests for limited partners, regardless of any general interest also held
C. No, but only if Astrid's limited partner interest represents less than 10% of total partnership capital and profits for the year
D. Yes, unless Astrid formally converts her limited partner interest into additional general partner units before the tax year closes

15. Sole proprietor caterer Odalys Ferreira takes a prospective client to dinner to discuss a catering contract, spending $180 on the meal, which is neither lavish nor extravagant and is properly substantiated. How much of this business meal expense may Odalys deduct on Schedule C?

A. The full $180, since business meals directly related to securing new client contracts are fully deductible without any percentage limitation

B. $90, since business meals with a client remain subject to the general 50% deduction limitation, while related entertainment costs are entirely nondeductible

C. $0, since meals combined with a business discussion are treated as nondeductible entertainment expenses following the Tax Cuts and Jobs Act

D. $144, since business meals are limited to 80% deductibility, matching the limitation applying to certain transportation-industry meal expenses

16. Two years ago, Partner Grantham Odom contributed appreciated land to Ashcombe Partners under Section 721. This year, Ashcombe distributes a different parcel of investment land, purchased separately and worth more than Grantham's remaining net precontribution gain, to Grantham in a nonliquidating distribution. What is the tax consequence to Grantham?

A. No gain is recognized, because Section 704(c)(1)(B) applies only when the partnership distributes the identical property a partner originally contributed

B. No gain is recognized, because mixing-bowl rules apply exclusively to distributions of cash, never to distributions of property to a contributing partner

C. Grantham recognizes gain under Section 737, limited to his remaining net precontribution gain, because he received other partnership property within the mixing-bowl period

D. Grantham recognizes gain equal to the full fair market value of the newly distributed parcel, without regard to his remaining net precontribution gain

17. Colton Vance rents, rather than owns, his apartment and uses one room exclusively and regularly as his sole proprietorship's home office, meeting all Section 280A requirements. He owns no depreciable residence. How does Colton compute his home office deduction under the actual expense method?

A. He may not use the actual expense method at all, since only homeowners who can claim depreciation qualify for actual-expense home office deductions

B. He must switch to the simplified method automatically, since renters are categorically barred from using the actual expense method for a home office

C. He applies the business-use percentage to his rent payments and other qualifying household expenses, in place of the depreciation a homeowner would otherwise claim

D. He deducts the full rent attributable to the entire apartment, since a renter's home office deduction is not subject to any business-use percentage limitation

18. Partner Ezinne Okoro contributes manufacturing equipment with a $70,000 fair market value and a $45,000 adjusted basis to Northgale Partners in exchange for a partnership interest, recognizing no gain under Section 721. What is Northgale Partners' basis in the contributed equipment immediately after the contribution?

A. $70,000, the equipment's fair market value at the time of contribution, since partnerships always take a stepped-up basis in property received from partners

B. $45,000, the same adjusted basis Ezinne had in the equipment, carried over to the partnership under Section 723

C. $25,000, the built-in gain inherent in the equipment at the time of contribution, representing the partnership's stake in future appreciation

D. $57,500, the average of the equipment's fair market value and Ezinne's adjusted basis, split evenly between the partnership and Ezinne

19. Investor Corwin Halbrook purchased 1,000 shares of Section 1244 qualifying small business stock directly from Ferrymoor Industries Inc. at original issuance for $120,000. The stock becomes entirely worthless during the year, and Corwin files a joint return with his spouse. What is the maximum amount of this loss Corwin may treat as an ordinary loss under Section 1244 for the year?

A. $120,000, the entire loss, since Section 1244 imposes no dollar limitation once stock becomes wholly worthless

B. $50,000 as ordinary loss, since the annual limit does not increase for taxpayers filing a joint return

C. $0 as ordinary loss, because Section 1244 applies only to sales or exchanges, never to worthless stock

D. $100,000 as ordinary loss, with the remaining $20,000 treated as capital loss, reflecting the joint-return limitation

20. Owen Castellan, a shareholder of Halberd Tool Corp., advances funds to the corporation and wants the advance respected as bona fide debt rather than reclassified as a capital contribution for federal tax purposes. Which characteristic of the advance would most strongly support debt treatment?

A. A fixed maturity date, a stated market interest rate, and an unconditional repayment obligation

B. Subordination to all general creditors with repayment made only from future profits

C. An advance amount strictly proportional to Castellan's existing stock ownership percentage

D. No written instrument, with repayment contingent entirely on future corporate earnings

21. Greywick Fabrication Inc., a C corporation, accumulates earnings well beyond the reasonable needs of its business and retains cash rather than paying dividends, primarily to help its shareholders avoid the individual income tax rate that would otherwise apply to dividend income. Under Section 531, what is the consequence to Greywick?

A. Greywick's shareholders are taxed currently on the undistributed earnings as though they had actually been distributed

B. Greywick itself becomes subject to the accumulated earnings tax on earnings retained beyond the reasonable needs of the business

C. Greywick automatically loses its C corporation status and is instead taxed as an S corporation

D. Greywick must distribute the excess earnings within 90 days or forfeit its state corporate charter

22. Halveston Aerostructures Inc., a C corporation, fails to pay sufficient estimated tax installments during the year, resulting in an underpayment for the year. Halveston's prior-year tax liability was based on a full 12-month return, and the corporation is not a 'large corporation' as defined for this purpose. Which safe harbor may Halveston use to avoid the Section 6655 estimated tax underpayment penalty?

A. Paying at least 90% of the current year's tax liability is the only safe harbor available to any corporation

B. Large corporations may always rely on the prior-year safe harbor regardless of their income level in any preceding year

C. No safe harbor exists for corporate estimated tax underpayments under any circumstances whatsoever

D. Paying installments based on 100% of the prior year's tax liability, since Halveston is not a large corporation

23. Northcastle Industries Inc. plans to spin off its underperforming division, Millrace Components, into a newly formed, wholly owned subsidiary, then distribute all of that subsidiary's stock pro rata to Northcastle's shareholders. Both corporations have actively conducted their respective trades or businesses for more than five years. For this spin-off to qualify as tax-free under Section 355, what must additionally be true?

A. The transaction must be motivated solely by a desire to reduce the combined entities' overall tax liability

B. Northcastle must retain at least 50% ownership of Millrace Components' stock after the distribution

C. The distribution must not be used principally as a device for distributing the earnings and profits of either corporation

D. Millrace Components must convert to an S corporation immediately before the distribution occurs

24. Ezra Whitcombe, the sole shareholder of Granite Peak Inc., wants to transfer stock to his grandson while preserving Granite Peak's S election. Granite Peak's shareholders wish to make a family aggregation election so that multiple family members are counted as a single shareholder for the 100-shareholder limit. Under Section 1361(c)(1), which relationship qualifies for this family aggregation treatment?

A. A common ancestor and all lineal descendants within six generations, plus spouses

B. Only siblings and their respective spouses, regardless of any common ancestor

C. Any unrelated individuals who jointly hold stock through a single custodial account

D. First cousins only, provided they share exactly one common grandparent

25. Talia Brennan, a shareholder of Ledger Rock Inc., an S corporation, had her stock basis reduced to zero and her $12,000 debt basis reduced to $4,000 by prior passed-through losses deducted against that debt basis. In the current year, Ledger Rock repays $6,000 of the loan while Brennan's debt basis remains at $4,000. What is the tax consequence to Brennan?

A. The repayment is entirely nontaxable because it merely returns her own funds

B. Brennan recognizes $2,000 of income because repayment exceeds her reduced debt basis

C. Brennan recognizes the full $6,000 repayment as ordinary compensation income

D. Brennan's stock basis is automatically increased by the full $6,000 repayment

26. Sable Ridge Inc., an S corporation with accumulated adjustments account (AAA) of $18,000 at the beginning of the year, incurs a $30,000 net loss for the year and later distributes $5,000 cash to its sole shareholder. How does Sable Ridge's AAA reflect this activity under the ordering rules?

A. AAA is reduced by the distribution before the loss is applied

B. AAA is increased by the loss because losses restore prior distributions

C. AAA is reduced by the loss first, then the distribution cannot reduce AAA below zero

D. AAA is unaffected by either the loss or the distribution this year

27. Grantley Holdings Inc. is an S corporation that was formerly a C corporation and still carries accumulated earnings and profits from its C corporation years. For three consecutive tax years, more than 25% of Grantley's gross receipts consist of passive investment income. What is the consequence under Section 1375 if this pattern continues into a fourth consecutive year?

A. Grantley's S election is automatically terminated as of the beginning of the following tax year

B. Grantley must distribute all of its accumulated earnings and profits within 90 days to avoid termination

C. Grantley is permanently barred from ever re-electing S status again under any circumstances

D. Grantley's shareholders, rather than the corporation itself, become liable for the excess passive income tax

28. Cinderpath LLC begins the year as a single-member LLC wholly owned by one individual who made no entity classification election, so it is disregarded for federal tax purposes. Mid-year, a second investor purchases a membership interest directly from the LLC, making Cinderpath a two-member LLC with no new Form 8832 filed. Under the check-the-box regulations, how is Cinderpath classified going forward?

A. It remains a disregarded entity until an affirmative election is filed

B. It automatically terminates and must be dissolved under state law

C. It is retroactively taxed as an S corporation from formation

D. It automatically becomes classified as a partnership without a new election

29. Fallowfield Corp., a C corporation, converts its business into a single-member LLC by distributing all of its assets to its sole shareholder in complete liquidation, and the shareholder then contributes those assets to a newly formed LLC. How is this corporation-to-LLC conversion treated for federal tax purposes?

A. As a nontaxable reorganization with full carryover basis to the LLC

B. As a taxable liquidation, with gain or loss recognized at both corporate and shareholder levels

C. As a tax-free Section 351 exchange because no third party is involved

D. As a disregarded transaction with no tax consequences at either level

30. Selena Duarte is a member of Briarcombe Ventures LLC, taxed as a partnership. Under the operating agreement, Duarte receives a fixed $4,000 monthly payment for management services regardless of Briarcombe's profitability that year. How is this payment characterized under Section 707(c)?

A. As a distributive share of partnership income reported on Schedule K-1 only

B. As wages subject to withholding, reported to Duarte on Form W-2

C. As a guaranteed payment, deductible by Briarcombe and ordinary income to Duarte

D. As a nontaxable return of Duarte's capital contribution to the LLC

31. Piper Lindqvist and Dorian Ashby form Ashcombe Corp., each transferring land and equipment for stock proportionate to the value transferred. Corinne Halloway, a longtime family friend, also transfers a small parcel of land worth $4,000 for stock, primarily so that Lindqvist and Ashby can satisfy the control requirement, while receiving stock worth less than 1% of Ashcombe's total outstanding shares. How does the IRS typically treat Halloway's transfer under Section 351?

A. It fully qualifies without limitation because any property transfer counts toward control

B. It is disregarded automatically, causing the entire exchange to fail Section 351

C. It converts the entire transaction into a taxable asset sale for all parties

D. It may be disqualified as an accommodation transfer that does not count toward control

32. Solmera Aerotech Inc., a large publicly traded corporation, reports average annual adjusted financial statement income exceeding $1 billion over the applicable three-year testing period. Under the corporate alternative minimum tax enacted by the Inflation Reduction Act, what is the general consequence to Solmera?

A. Solmera becomes subject to a 15% minimum tax computed on its adjusted financial statement income

B. Solmera is automatically reclassified as a personal holding company subject to additional tax

C. Solmera's shareholders, rather than the corporation, bear the alternative minimum tax liability

D. Solmera is exempt from the corporate alternative minimum tax because its regular tax rate already exceeds 15%

33. Fennwright Holdings Inc. establishes a wholly owned captive insurance subsidiary and pays substantial annual premiums to it, deducting these premiums as ordinary business insurance expense. The captive insures only risks of its parent and affiliated entities, with no meaningful risk distribution among unrelated insureds. Is Fennwright Holdings entitled to deduct these premiums as insurance expense?

A. Yes, any payment labeled as an insurance premium to a licensed captive insurer is automatically deductible

B. Not necessarily; deductibility requires genuine risk shifting and risk distribution, which a captive insuring only its own affiliated group may lack

C. Yes, because Section 831(b) exempts all captive insurance premiums from IRS scrutiny automatically

D. No, captive insurance arrangements are categorically prohibited from ever qualifying as insurance for federal tax purposes

34. Individual Cordelia Ashbourne owns all the stock of both Rathmore Corp and Thistlecroft Corp, two commonly controlled corporations. Cordelia sells some of her Rathmore stock to Thistlecroft for cash. Under Section 304, how is this brother-sister stock sale generally treated?

A. As a tax-free exchange, since both corporations are under common ownership and control

B. As an installment sale automatically, regardless of the actual payment terms used

C. As a redemption of Thistlecroft stock, tested under Section 302 to determine dividend versus sale treatment

D. As a like-kind exchange under Section 1031, since both interests are shares of corporate stock

35. Tamsin Elgrove holds a membership interest in Fennimore Capital Advisors LLC, a firm taxed as a partnership. Rather than functioning as a passive capital investor, she works full-time on-site directing the firm's client engagements and daily operations. Does her LLC interest, standing alone, entitle her to the limited-partner exception from self-employment tax under Section 1402(a)(13)?

A. No, courts and the IRS generally examine the member's actual role and participation, not merely the LLC label, before applying the limited-partner exception

B. Yes, any LLC member is automatically treated as a limited partner regardless of actual participation in the business

C. Yes, because LLC members can never be subject to self-employment tax under any circumstances

D. No, because LLC members are always treated as general partners for self-employment tax purposes

36. Garrick, a self-employed IT consultant, completes a project for Holloway Fixtures and accepts a used delivery van in full payment instead of cash. The van's fair market value is $9,500, though Holloway's original cost basis in the van was $14,000. How much must Garrick include in gross income for the services performed?

A. $14,000, Holloway's original cost basis in the van.

B. Zero, since no cash actually changed hands in the deal.

C. $4,500, the difference between cost basis and market value.

D. $9,500, the fair market value of the van received.

37. Emberton Wholesale Co. uses the FIFO method to value inventory. During the year, it purchased 200 units at $10 each in March and 300 units at $13 each in September. At year-end, 250 units remain on hand. Under FIFO, what is the value of Emberton's ending inventory?

A. $2,500, valuing all remaining units at the March cost.

B. $3,250, valuing remaining units at the September per-unit cost.

C. $2,975, using a blended average cost per unit basis.

D. $3,900, valuing all 300 September units as still on hand.

38. Marchetti & Vale, PC, a qualified personal service corporation performing legal services, has average annual gross receipts well above the inflation-adjusted small business threshold under Section 448(c). Substantially all of the firm's stock is owned by employees who perform the legal services. May the firm still use the cash method of accounting?

A. No, C corporations exceeding the threshold must use accrual.

B. No, unless the firm converts to an S corporation first.
C. Yes, but only for the firm's first three years of operation.
D. Yes, qualified personal service corporations are exempt from the test.

39. Thistlewood Hardware, a retailer required to account for inventory, uses the accrual method for purchases and sales of merchandise but reports its interest income and rental income under the cash method. Under Reg. Section 1.446-1(c)(1)(iv), what condition must this hybrid method satisfy to be permissible?

A. The IRS must pre-approve every hybrid combination in writing.
B. Interest income must always be reported using the accrual method.
C. The combination must clearly reflect income and be applied consistently.
D. Rental income may never be included in a hybrid method.

40. Kestrel Data Solutions, Inc., a newly electing S corporation, wants to adopt a September 30 fiscal year under Section 444 instead of the required calendar year, without establishing a business purpose. What must Kestrel do to retain this elected tax year?

A. Make an annual required payment under Section 7519 for deferral.
B. File Form 3115 requesting IRS consent every year for renewal.
C. Distribute all deferred income to shareholders before year-end closes.
D. Obtain unanimous shareholder consent to the deferral each year.

41. Duskwood Builders Inc. is a small contractor whose average annual gross receipts for the preceding three years fall below the inflation-adjusted small contractor exception threshold under Section 460(e). Duskwood enters into a two-year home construction contract. May Duskwood use the completed-contract method instead of the percentage-of-completion method for this contract?

A. No, the percentage-of-completion method is mandatory for every contract exceeding one year in duration
B. Yes, home construction contracts and contracts of qualifying small contractors are excepted from the percentage-of-completion requirement
C. No, only contracts lasting under six months qualify for the completed-contract method

D. Yes, but only if Duskwood also elects out of the installment method for all of its other sales

42. Granton Industrial LLC exchanges business real property with its wholly owned subsidiary in a transaction qualifying for Section 1031 nonrecognition. Nine months after the exchange, the subsidiary sells the property it received to an unrelated buyer. Under Section 1031(f), what is the effect of this early disposition?

A. The exchange remains fully tax-free with no further consequences.
B. Only the subsidiary, not Granton, must recognize deferred gain now.
C. Both related parties must recognize the previously deferred gain now.
D. The two-year rule applies only to exchanges of personal property.

43. Elowen Timber Co. holds a warehouse used in its trade or business that is condemned by the city government, and Elowen realizes gain on the condemnation award received. For real property held for productive use in a trade or business that is condemned, how long does Elowen have to acquire qualifying replacement property under Section 1033?

A. Six months from the date the condemnation award is received.
B. One year from the close of the tax year of gain.
C. Two years from the close of the tax year of gain.
D. Three years from the close of the tax year of gain.

44. Vasquez Millwork Corp voluntarily changes its accounting method by filing Form 3115, generating a positive Section 481(a) adjustment that increases taxable income. How must Vasquez generally account for this positive adjustment under the standard automatic change procedures?

A. Spread the adjustment ratably into income over four tax years.
B. Report the entire adjustment in the year of change only.
C. Spread the adjustment ratably over ten tax years instead.
D. Amend the three prior years' returns to reflect the change.

45. Northgate Engineering Associates enters into a contract to provide design and engineering consulting services related to a client's planned manufacturing plant, but does not itself build or manufacture anything. The contract will span twenty months. Is this contract subject to the long-term contract methods of Section 460?

A. Yes, because any contract exceeding twelve months qualifies automatically.
B. No, because pure service contracts fall outside Section 460's scope.
C. Yes, but only if Northgate's gross receipts exceed the threshold.
D. No, only because Northgate is organized as a partnership entity.

46. Preswick Fabricators Inc. receives a $60,000 payment from a customer under a contract term the customer is actively disputing in ongoing litigation. Preswick has unrestricted use of the funds, and no obligation yet requires repayment. Under the claim-of-right doctrine, how must Preswick treat this $60,000 for the current year?

A. Exclude the entire amount from income until litigation concludes.
B. Report it only as a liability, not as income, this year.
C. Include only half now, deferring the rest until resolution.
D. Include the full amount in gross income for the current year.

47. Marrow & Chase Wholesale, a reseller subject to Section 263A, has $40,000 of purchasing department costs and $10,000,000 of total inventory costs, producing a simplified resale method absorption ratio of 0.4%. If Marrow's ending inventory before adjustment is $500,000, what additional Section 263A cost must be capitalized to inventory?

A. $40,000, the full purchasing department cost for the year.
B. $500,000, the entire ending inventory balance before adjustment.
C. $2,000, the absorption ratio applied to ending inventory value.
D. $10,000, an amount unrelated to the absorption ratio calculation.

48. Anchorpoint Supply Co. adopts the LIFO method for valuing its inventory for tax purposes. Its financial accountant proposes also applying the lower of cost or market method to further write down slow-moving inventory items. May Anchorpoint combine LIFO with lower of cost or market valuation for tax purposes?

A. No, LIFO inventory must be valued at cost, not market.
B. Yes, combining both methods is required for LIFO taxpayers.
C. Yes, but only for items held longer than one year.
D. No, because LIFO may only be used by retail businesses.

49. Declan Osei sells business real property in an installment sale with total installment obligations exceeding $5,000,000 outstanding at year-end, and later uses that installment note as collateral to secure a bank loan. Under the pledge rule of Section 453A(d), how is the loan proceeds treated for tax purposes?

A. As a payment received on the installment obligation, accelerating gain.
B. As a tax-free loan with no effect on the installment sale.
C. As additional interest income reportable in the following year.
D. As a like-kind exchange requiring a new deferred gain election.

50. Ravensworth Distributors Inc. elects to use the LIFO inventory method for federal tax purposes beginning this year. Under the LIFO conformity requirement of Section 472(c), what must Ravensworth do regarding the financial statements it issues to shareholders and creditors?

A. Ravensworth may freely use FIFO or average cost in its financial statements regardless of its LIFO tax election
B. Ravensworth generally may not use any inventory method other than LIFO in the financial statements it issues to shareholders and creditors
C. Ravensworth must obtain IRS pre-approval before issuing any financial statements after electing LIFO
D. The conformity requirement applies only to publicly traded corporations, not privately held ones like Ravensworth

51. Blackthorn Retail Group renovates the interior of a nonresidential building it has owned and used in business for several years, adding new interior partition walls and updated lighting fixtures, while leaving the building's structural framework, elevators, and overall footprint untouched. How is this qualified improvement property classified for MACRS purposes?

A. 39-year property, depreciated on the same recovery schedule as the underlying building structure

B. 5-year property, matching the classification given to movable office furniture and equipment

C. Nondepreciable, since interior improvements to a building already owned are treated as ordinary repairs

D. 15-year property, eligible for bonus depreciation as qualified improvement property under current law

52. Castellan Precision Tools Inc. paved a new parking lot and installed a related drainage system adjacent to its manufacturing plant. For MACRS purposes, how is this land improvement classified?

A. It is 5-year property, the same class as the manufacturing equipment inside the plant.

B. It is 39-year property, the same recovery period as the plant building itself.

C. It is 15-year property, depreciated separately from the building under its own class life.

D. It is nondepreciable property because land improvements attach permanently to the underlying land.

53. Sable Peak Consulting elected to expense $140,000 of qualifying equipment under Section 179 for 2025, but the firm's aggregate business taxable income before the deduction, computed under Section 179(b)(3), was only $95,000. How is the disallowed portion treated?

A. The disallowed $45,000 is permanently lost and may never be deducted in any year.

B. The disallowed $45,000 carries forward indefinitely and is deductible in a later year with sufficient income.

C. The disallowed $45,000 must instead be claimed as bonus depreciation in the current year.

D. The disallowed $45,000 converts automatically into a net operating loss carryback.

54. Before opening its doors, Ellendale Consulting LLC incurs $8,000 of investigative and start-up costs while researching and organizing its new consulting practice. Once the business begins active operations, how may Ellendale treat these start-up expenditures under Section 195?

A. The full $8,000 must be capitalized permanently, with no amortization ever allowed

B. The full $8,000 must be deducted entirely in the year the business begins active operations

C. The $8,000 must be spread ratably over exactly 15 years, identical to Section 197 intangibles

D. Up to $5,000 may be currently deducted, subject to phase-out, with the remainder amortized over 180 months

55. Thornfield Veterinary Clinic purchased a camera-equipped drone used to monitor its outdoor kennel facility. The drone is listed property under Section 280F. To use accelerated MACRS depreciation rather than the straight-line alternative depreciation system, what business-use threshold must the drone satisfy?

A. Business use must equal or exceed 25% of total use for the tax year.

B. Business use must equal or exceed exactly 40% of total use for the tax year.

C. Business use must exceed 50% of total use for the tax year.

D. Business use must equal 100%, with no personal use permitted whatsoever.

56. Quillon Robotics Corp spent $90,000 internally developing a proprietary customer list through its own marketing department, without acquiring the list or any related business from another party. How is this self-created customer list treated under Section 197?

A. It is excluded from Section 197 because the intangible was self-created rather than acquired from another taxpayer.

B. It must be amortized over 15 years, the same as any purchased customer list.

C. It is treated as goodwill and amortized identically to acquired goodwill under Section 197.

D. It is capitalized permanently with no amortization allowed, since it lacks a determinable acquisition cost.

57. Thornquist Fabrication LLC operates a manufacturing facility located on an Indian reservation and employs enrolled tribal members and their spouses who both live and work on or near the reservation. Thornquist increases qualified wages and health insurance costs paid to these employees compared to the prior year. Under Section 45A, how is the Indian employment credit generally computed?

A. As a flat percentage of total payroll costs for the entire facility, regardless of any wage increase

B. As a deduction, rather than a credit, equal to the qualified wages paid to enrolled tribal members

C. As a credit equal to 100% of all wages paid to qualifying employees during the year

D. As 20% of the excess of current-year qualified wages and health insurance costs over the corresponding prior-year amounts, subject to a per-employee wage cap

58. Foxhollow Landscaping LLC hires a WOTC-eligible worker from a targeted group. The employee works 250 hours during the first year of employment, more than 120 but fewer than 400 hours. How does this affect the Work Opportunity Tax Credit percentage applied to first-year wages?

A. The full 40% credit rate applies, since the employee exceeded the 120-hour minimum threshold.
B. No credit is allowed because the employee did not reach the 400-hour full-year threshold.
C. A reduced 25% credit rate applies instead of the 40% rate used for 400 or more hours.
D. The credit rate doubles to 80% as a penalty for the employer's short-term hiring.

59. Granton Pharmaceuticals Inc. incurs costs conducting research after a new manufacturing process has already reached commercial production, essentially routine quality-control testing rather than experimentation to resolve technical uncertainty. For Section 41 research credit purposes, how are these costs treated?

A. They fully qualify as research expenses because Granton is a pharmaceutical manufacturer engaged in ongoing innovation.
B. They are excluded from qualified research because research after commercial production begins does not meet Section 41's definition.
C. They qualify at a reduced 50% rate reflecting their post-production timing.
D. They qualify only if Granton also claims the orphan drug credit in the same year.

60. Brindlewood Medical Devices Inc. wants to determine whether it qualifies as an 'eligible small business' for purposes of claiming the Disabled Access Credit under Section 44. Which of the following correctly states the eligibility threshold?

A. Gross receipts of $1,000,000 or less, or no more than 30 full-time employees, in the preceding year.
B. Gross receipts of $5,000,000 or less, or no more than 100 full-time employees, in the preceding year.
C. Fewer than 25 full-time equivalent employees with average annual wages below a statutory threshold.
D. Any business regardless of size, provided the expenditures relate to ADA compliance.

61. Ophira Health & Wellness Spa provides one-on-one medically supervised counseling and treatment services performed directly by licensed practitioners for clients, with income earned primarily from the practitioners' skill and reputation. How is this business classified for Section 199A purposes?

A. It is a specified service trade or business in the field of health, subject to the SSTB income-threshold phase-out.

B. It is not an SSTB because wellness spas are specifically excluded from the health services category.

C. It qualifies as a non-SSTB trade or business because it sells retail wellness products alongside its services.

D. It is automatically disqualified from any QBI deduction regardless of the owner's taxable income level.

62. Tobias Renshaw owns units in a publicly traded partnership and shares of a real estate investment trust, receiving $18,000 of qualified PTP income and REIT dividends during 2025, in addition to separate QBI from his sole proprietorship. How is the qualified REIT dividend and PTP income component of his Section 199A deduction computed?

A. It is combined with QBI and subject to the same 50% W-2 wage limitation once income exceeds the threshold.

B. It is disregarded entirely because REIT dividends and PTP income never qualify for a Section 199A deduction.

C. It is limited to the UBIA of qualified property held by the REIT or partnership.

D. It receives a 20% deduction computed separately, with no wage or UBIA limitation and no SSTB restriction applied.

63. Simone Achterberg, single, has taxable income of $250,000 in 2025, fully above the applicable QBI phase-in range, from a non-SSTB manufacturing business with $40,000 of W-2 wages and $600,000 of unadjusted basis immediately after acquisition (UBIA) of qualified property. Her tentative QBI deduction before the limitation is $60,000. How is the wage/UBIA limitation applied?

A. The deduction is capped at 50% of W-2 wages only, ignoring UBIA entirely for manufacturing businesses.

B. The deduction is capped at 2.5% of UBIA only, since W-2 wages are relatively low.

C. The deduction is capped at the greater of 50% of W-2 wages or 25% of W-2 wages plus 2.5% of UBIA.

D. The deduction is capped at the lesser of 50% of W-2 wages or 25% of W-2 wages plus 2.5% of UBIA.

64. Castille Employer Services, a qualifying small employer, purchases health insurance for its employees through the SHOP Marketplace and wants to claim the small employer health insurance credit under Section 45R. What is the maximum credit percentage of premiums paid for a taxable (non-tax-exempt) eligible small employer?

A. 35% of premiums paid, the same rate available to tax-exempt eligible small employers.

B. 50% of premiums paid, before any reduction for the average-wage and employee-count phase-out.

C. 100% of premiums paid, provided the employer covers all full-time employees.

D. 25% of premiums paid, matched by an equivalent state-level tax credit.

65. Dunmore Physical Therapy Clinic sold 5-year MACRS office equipment on March 15 of the current year, after using the half-year convention when the equipment was placed in service. How much depreciation may the clinic claim for the equipment in the year of disposition?

A. A full year of depreciation, since the equipment was in service for part of the year.

B. No depreciation, since the equipment was sold before the midpoint of the tax year.

C. One-half of the otherwise allowable annual depreciation, regardless of the actual disposition date.

D. Depreciation prorated by the exact number of days the equipment was held during the year.

66. Bishop Hardware Supply anticipates its total employment tax liability (federal income tax withholding plus both shares of FICA) for the calendar year will be $950, well under the threshold for quarterly reporting. The IRS has not yet notified the business of its filing requirement. What must Bishop Hardware Supply do to file Form 944, Employer's ANNUAL Federal Tax Return, instead of quarterly Forms 941?

A. File Form 944 without notifying the IRS, since any employer with a liability under $1,000 automatically qualifies for annual filing

B. Contact the IRS to request Form 944 eligibility, since only employers the IRS has notified in writing may file it instead of Form 941

C. File Form 944 only after first filing a full year of Forms 941 to establish a liability history under $1,000

D. File Form 944 automatically the first time actual liability falls under $1,000, without any IRS contact required

67. GreenPath Builders has consistently treated Dario Fenwick as an independent contractor for three years, but Dario now believes he was misclassified and should have been treated as a common-law employee. Dario wants a formal IRS determination of his worker status so he can properly report his employment tax situation. Which form should Dario file with the IRS to request this determination?

A. Form 8919, used to report an employee's uncollected Social Security and Medicare tax on wages

B. Form 8952, the application for the Voluntary Classification Settlement Program for reclassifying workers

C. Form 941-X, the adjusted employer's quarterly federal tax return used to correct prior filings

D. Form SS-8, used to request an IRS determination of a worker's federal employment tax status

68. Calloway Freight Co. pays a nondiscretionary year-end bonus to an employee as a supplemental wage payment, identified and paid separately from the employee's regular wages. The employee's supplemental wages for the year total less than $1 million, and income tax has been withheld from the employee's regular wages during the current or preceding calendar year. Under these facts, what withholding rate may Calloway Freight Co. apply to the bonus under the optional flat-rate method?

A. A flat 22 percent, applied to the bonus without regard to the employee's Form W-4 elections

B. The employee's marginal individual income tax bracket rate, determined from the prior year's Form 1040

C. A flat 37 percent, mandatory whenever a bonus is paid separately from regular wages

D. The same percentage-method rate used for the employee's regular wages, aggregated together

69. Bellhurst Design Studio reimburses its employees for business travel expenses. To ensure these reimbursements are excluded from the employees' wages and avoid payroll tax withholding, what must Bellhurst's reimbursement arrangement satisfy under the accountable plan rules?

A. Employees need only submit a verbal estimate of expenses within a reasonable time to qualify for exclusion

B. The arrangement must require a business connection, adequate substantiation, and return of any excess amounts within a reasonable time

C. Reimbursements are automatically excludable regardless of substantiation, as long as they do not exceed the standard per diem rate

D. The employer must report all reimbursements as supplemental wages regardless of how well they are substantiated

70. The Copper Skillet, a full-service restaurant, pays the employer share of FICA tax on tips reported by its food and beverage employees. The restaurant's tipped employees are paid a cash wage below the amount that, combined with tips, would exceed the federal minimum wage threshold used for this purpose. What favorable federal income tax treatment may the restaurant claim for the employer FICA tax it pays on these reported tips?

A. An itemized deduction limited to 50 percent of the employer FICA tax paid on tips

B. A full exclusion of the employer FICA tax paid from the restaurant's gross income

C. An accelerated depreciation allowance equal to the FICA tax paid on tips

D. A general business credit under Section 45B equal to the employer FICA tax paid on tips exceeding the minimum-wage threshold

71. Self-employed architect Thaddeus Winterbourne travels to meet a prospective client and wants to substantiate the trip's deductibility under Section 274's strict substantiation rules. Which five elements must Thaddeus's contemporaneous records establish for this travel expense to be deductible?

A. The amount, time, place, business purpose, and business relationship associated with the expense

B. Only the amount and business purpose; time and place are optional under simplified recordkeeping rules

C. The mode of transportation, hotel star rating, meal preferences, and the client's job title

D. A signed statement from the client confirming the meeting occurred, with no other documentation required

72. Desmond Ruiz, a self-employed tax preparer, sets aside a spare bedroom used solely for his business — no personal activity ever occurs there — but he only works in that room about two afternoons per month, doing most of his client work elsewhere. Does Desmond's spare bedroom qualify for the home office deduction under Section 280A?

A. Yes, because meeting the exclusive-use test alone is sufficient regardless of how often the space is actually used
B. Yes, because occasional use of an exclusively dedicated space is presumed to satisfy the regular-use test automatically
C. No, because the space must be used both exclusively and on a regular basis, and infrequent use fails the regular-use requirement
D. No, because a spare bedroom can never qualify as a home office regardless of usage pattern

73. Petra Lindqvist operates a delivery service and simultaneously owns and uses six vehicles in the business during the year, with multiple vehicles often on the road at the same time. Petra wants to use the standard mileage rate for all six vehicles. Is she permitted to do so?

A. Yes, the standard mileage rate applies to any number of vehicles used more than half the time for business
B. Yes, provided Petra separately tracks total combined fleet mileage rather than mileage for each individual vehicle owned
C. No, the standard mileage rate cannot be used for a fleet operation involving five or more vehicles used simultaneously
D. No, the standard mileage rate is limited to taxpayers who own no more than two business vehicles in total

74. Julian Ferris leases a passenger automobile with a fair market value exceeding the luxury vehicle threshold and uses the actual expense method, deducting his lease payments based on business-use percentage. Because the vehicle's value exceeds the applicable threshold, what additional adjustment must Julian make?

A. Julian must depreciate the leased vehicle himself using MACRS instead of deducting any of his lease payments
B. Julian must include a lease inclusion amount in gross income, prorated for business-use percentage, offsetting part of the deduction

C. Julian must reduce his allowable lease deduction to zero for any vehicle exceeding the luxury threshold

D. Julian must amortize the excess lease value over the vehicle's remaining useful life as a Section 197 intangible

75. Camille Brandt, a self-employed sales representative, does not keep a daily mileage log for her entire vehicle but instead maintains detailed records for a representative twelve-week sample period that reflects her typical business use pattern throughout the year. For substantiation purposes, how may Camille use this sample under the Section 274 recordkeeping regulations?

A. She may not; a sample period is never adequate, and a complete daily log is mandatory for the entire year

B. She may use the sample only if it covers at least nine consecutive months of the year

C. She may use the sample, but only if she also obtains written confirmation of business use from each client visited

D. She may use the sample to establish business-use for the full year, provided the sampled period is representative of her overall usage pattern

76. Simon Cutter operates a sole proprietorship and also earns $150,000 in wages from an unrelated employer during the same year, on which Social Security tax was fully withheld. His net earnings from self-employment are $40,000. In computing the Social Security portion of his self-employment tax, how is the annual wage base applied?

A. The wage base already used by his $150,000 of W-2 wages reduces his self-employment earnings subject to the Social Security portion, potentially to zero

B. The wage base applies separately to each income source, so his full $40,000 of net self-employment earnings remains subject to the Social Security portion

C. His self-employment earnings are entirely exempt from the Social Security portion whenever any wages were earned from a different, unrelated employer during the year

D. The wage base effectively doubles for any taxpayer who has both wage income and self-employment income during the very same calendar year

77. Sole proprietor Osbert Trentham, owner of Palmeroy Creative Studio, pays independent contractor Owen Delacroix over $600 during the year for freelance graphic design work, but Owen repeatedly fails to furnish his taxpayer identification number despite Osbert's requests. What is Osbert generally required to do regarding these payments?

A. Withhold backup withholding at the applicable statutory rate from future payments to Owen and remit it to the IRS

B. Refuse to pay Owen anything further until any dispute over the missing identification number is resolved

C. Report the payments as tax-exempt income, since a missing taxpayer identification number relieves any withholding obligation

D. Automatically reclassify Owen as a common-law employee solely because his identification number is missing

78. Corvid Freight Logistics Inc. withholds federal income tax and FICA from its employees' wages, but its CFO, who has check-signing authority, knowingly diverts the withheld funds to cover other business expenses instead of remitting them to the IRS, causing the required deposits to go unpaid. Against whom may the IRS assess the trust fund recovery penalty under Section 6672?

A. Only against Corvid Freight Logistics Inc. itself, since penalties are never assessed against individual officers

B. Only against the employees whose withholding was diverted, since they bear the ultimate underlying tax liability

C. Only against the company's outside payroll service provider, if the company used one

D. Personally against the CFO, as a responsible person who willfully failed to remit the withheld trust fund taxes

79. Castlemere Industries pays a single employee wages of $210,000 during the year from Castlemere alone; the employee is married and files jointly with a spouse who earns no income, so their combined household threshold for Additional Medicare Tax is higher than $200,000. Must Castlemere withhold Additional Medicare Tax on this employee's wages?

A. No, because the employee's joint-filing threshold exceeds $200,000, so no withholding is required from any single employer

B. No, unless the employee submits a written request asking Castlemere to withhold the additional amount

C. Yes, Castlemere must withhold once this employee's wages from Castlemere alone exceed $200,000, regardless of filing status or expected liability
D. Yes, but only if Castlemere is also the employee's sole employer for the entire calendar year

80. Executor Miles Corbett is newly appointed to administer a decedent's estate and wants the IRS to formally recognize his authority to act on the estate's behalf, including receiving official notices, before the estate's first Form 1041 is due. Which form accomplishes this?

A. Form 2848, granting power of attorney to a paid representative
B. Form 56, giving notice of the fiduciary relationship
C. Form 8822-B, reporting a change of business address
D. Form 4868, requesting an automatic filing extension

81. A calendar-year decedent's estate, a trust required to distribute all its income currently, and a trust permitted to accumulate income are each computing taxable income on separate Forms 1041 for the year. Under Section 642(b), what personal exemption amount does each entity generally deduct?

A. $600 for the estate, $100 for the simple trust, and $300 for the complex trust
B. $300 for the estate, $600 for the simple trust, and $100 for the complex trust
C. $600 for the estate, $300 for the simple trust, and $100 for the complex trust
D. $100 for the estate, $300 for the simple trust, and $600 for the complex trust

82. Trustee Odalys Marchetti manages a trust holding a rental office building, and the trust instrument is silent on how the depreciation deduction should be allocated between the income beneficiary and the remainder beneficiary. Absent instrument language, how is depreciation generally allocated for fiduciary accounting purposes?

A. Entirely to the income beneficiary, leaving no reserve for the corpus
B. Entirely to the remainder beneficiary, since depreciation protects the corpus
C. Equally between the beneficiaries, regardless of their accounting income shares
D. Between the trust and beneficiaries based on their shares of accounting income

83. Grantor Petra Loewen creates an irrevocable trust for her three adult children. The independent, non-adverse trustee has sole discretion, without any beneficiary's consent, to decide each year how much income each child receives, and no party holds a substantial adverse interest in that decision. Under Section 674, how is the trust treated?

A. As a complex trust taxed on income not currently distributed

B. As a grantor trust, because a non-adverse party controls beneficial enjoyment of income

C. As a simple trust, because all income is eventually distributed

D. As a qualified subchapter S trust automatically

84. Executor Ines Thackston is preparing the first Form 1041 for a decedent's estate that has not yet made a tax year election. Unlike a trust, which must generally adopt a calendar year, what year-end may the estate select for its return?

A. Any fiscal year-end the executor selects, so long as the period stays within 12 months

B. Only a calendar year-end, identical to the decedent's final individual return

C. Only the anniversary month of the decedent's date of death

D. Only a fiscal year ending the month before the date of death

85. A decedent's will directs the executor to pay a specific bequest of $75,000 in cash to a named grandchild, payable in a single lump sum out of estate corpus. The estate also has substantial DNI for the year from its investment income. How does this specific bequest affect the estate's income distribution deduction?

A. It fully carries out DNI to the grandchild, taxable to her up to $75,000

B. It carries out DNI only to the extent estate cash exceeds its debts

C. It is deductible by the estate only if the grandchild elects to report it

D. It does not carry out DNI, since it is a specific sum paid in three or fewer installments

86. A tax-exempt trade association hosts an annual conference. A corporate sponsor pays the association $40,000 for its name and logo to be displayed on conference banners, with no advertisement of the sponsor's products, no comparative qualitative statements, and no call to action. How should the association treat this payment for UBIT purposes?

A. As unrelated advertising income, fully subject to UBIT
B. As unrelated income unless the sponsor is also a member of the association
C. As a qualified sponsorship payment excluded from unrelated business taxable income
D. As royalty income subject to UBIT because a trade name was used

87. A tax-exempt professional association holds its annual trade show, renting booth space to exhibitors who display and sell products related to the association's exempt purpose, educating members and the public about industry developments. Under the qualified convention and trade show activity exception, how is this booth rental income treated?

A. Excluded from unrelated business taxable income as a qualified trade show activity
B. Fully taxable as unrelated rental income from personal property
C. Taxable only on the portion attributable to for-profit exhibitors
D. Excluded only if the trade show is held in the same city every year

88. A private foundation named as residuary beneficiary in a decedent's will receives, upon the estate's closing, a 35% interest in a family-owned furniture manufacturing business, an amount that immediately exceeds the excess business holdings ceiling under Section 4943. The foundation had no pre-existing interest in the business. From the date of receipt, how long does the foundation generally have to bring its holdings within the permitted limit before the initial excise tax applies?

A. 180 days from the date the estate formally closes and distributes the interest
B. A five-year period, running from the date the foundation receives the interest by gift or bequest
C. Ten years, matching the general long-term holding period used for capital gains purposes
D. The foundation must divest immediately upon receipt, with no grace period available at all

89. An organization qualifies as publicly supported under Section 509(a)(2) rather than Section 509(a)(1) because it receives substantial fee-for-service revenue from its exempt activities. In addition to the broad public support requirement, what additional limitation must this organization satisfy that a 509(a)(1) organization does not?

A. It must receive at least 50% of its support from a single government grant

B. It must spend at least 5% of its assets on charitable activities annually
C. It must be organized as a supporting organization for another public charity
D. It must limit combined investment income and unrelated business income to one-third of total support

90. A tax-exempt organization organized as a charitable trust and a tax-exempt organization organized as a nonprofit corporation each generate $50,000 of unrelated business taxable income this year. How is the UBIT computed for each organization?

A. Both compute UBIT using the flat corporate tax rate, regardless of organizational form
B. The trust computes UBIT using trust income tax rates, while the corporation uses corporate tax rates
C. Both compute UBIT using the same compressed trust rate schedule
D. Neither organization pays UBIT unless its unrelated income exceeds $1,000,000

91. Wrenfield Veterinary Supply had 85 employees who each earned more than $5,000 in the prior calendar year. The employer wants to establish a SIMPLE IRA plan for the upcoming plan year instead of a traditional 401(k). Under the SIMPLE plan eligibility rules, is Wrenfield permitted to adopt this plan?

A. Yes, but only if the employer maintains no other qualified retirement plan for any employee ever
B. No, because SIMPLE plans are limited to employers with fewer than 25 employees
C. Yes, because the employer had no more than 100 employees earning at least $5,000 in the prior year
D. No, because SIMPLE IRA plans require at least 100 employees to be cost-effective

92. A calendar-year business wants to adopt a brand-new profit-sharing plan for the year that just ended and still receive a deduction for that year. Under current law, by what deadline may the employer formally adopt this new qualified plan?

A. By the employer's tax return due date, including extensions, for that year
B. By March 15 of the following year only
C. By September 30 following the close of the plan year
D. By December 31 of the plan year, with no extensions permitted

93. An employer's qualified retirement plan covers 60% of its non-highly compensated employees. The plan must also satisfy minimum coverage requirements under Section 410(b). Using the ratio percentage test, what threshold must the plan's coverage of non-highly compensated employees reach relative to highly compensated employee coverage?

A. Coverage of non-highly compensated employees must equal exactly 100% of highly compensated employee coverage

B. The plan automatically passes if any non-highly compensated employees are covered at all

C. Coverage of non-highly compensated employees must be at least 70% of the coverage rate for highly compensated employees

D. The plan must cover at least 50% of all employees regardless of compensation level

94. An employer formally terminates its profit-sharing plan mid-year due to a business closure. Several participants had not yet completed enough years of service to be fully vested under the plan's graded vesting schedule. What happens to their account balances upon plan termination?

A. Unvested amounts are forfeited immediately and reallocated to remaining highly compensated participants

B. All affected participants become 100% vested in their account balances as of the termination date

C. Vesting continues on the original schedule even though the plan no longer exists

D. Unvested amounts revert to the employer only if the plan was top-heavy

95. Farmer Delphine Marrow has a high-income year and wants to elect farm income averaging under Schedule J. Her income for the year includes net income from raising and selling cattle, plus a separate gain from selling 40 acres of farmland she no longer wishes to cultivate. Which amount may she include as elected farm income?

A. Only the cattle income; gain from the sale of the farmland itself does not qualify as elected farm income

B. Both the cattle income and the land sale gain, since both relate to her farming business

C. Only the land sale gain, since income averaging applies solely to property dispositions

D. Neither amount, because income averaging is unavailable in any year land is sold

96. Cornfield Harvest Corp is a C corporation engaged exclusively in farming and qualifies as a family corporation because a single family owns substantially all of its stock. General tax law requires most C corporations engaged in farming to use the accrual method. Under Section 447, what exception applies to Cornfield?

A. Family farming corporations must switch to accrual regardless of ownership structure

B. No exception exists; every farming C corporation must use the accrual method

C. Family farming corporations may use the cash method only if gross receipts exceed $50 million

D. A qualifying family farming corporation may continue using the cash method regardless of gross receipts

97. Cash-method Farmer Silas Bramhall's wheat crop is destroyed by hail in October, and he receives both federal crop insurance proceeds and a payment under the USDA Noninsured Crop Disaster Assistance Program for the same destroyed crop, both received in the same year as the damage. He wants to defer only the crop insurance proceeds to next year while reporting the disaster payment now. Is this permitted?

A. Yes, because the two payment sources are eligible for separate, independent deferral elections

B. No, the election must apply to all crop and disaster payments received in the damage year

C. Yes, but only if he reports income using the accrual method

D. No, because disaster payments are never eligible for deferral under any circumstances

98. Investor Petronella Kingswell sells a rental apartment building she has depreciated using the straight-line method, recognizing a $90,000 gain, all attributable to depreciation previously claimed. She has no ordinary-income Section 1250 recapture because straight-line depreciation was used. At what maximum federal rate is this unrecaptured Section 1250 gain taxed?

A. Ordinary income rates with no cap, since all depreciation must be recaptured as ordinary income

B. The same 0%, 15%, or 20% long-term capital gain rates as other real property gain

C. A flat 28% rate identical to the rate applied to collectibles gain

D. A maximum rate of 25%, as unrecaptured Section 1250 gain

99. Property manager Perpetua Larkham spends 900 hours during the year materially participating in her rental real estate activities and works in no other trade or business, well over half of her total working hours for the year in real property trades. Does Perpetua qualify as a real estate professional under Section 469(c)(7), allowing her rental losses to escape the passive activity limitation?

A. Yes, since she exceeds both the 750-hour minimum and the more-than-half-of-working-time test for real property trades

B. No, because real estate professional status requires at least 1,000 hours annually regardless of other work

C. No, because rental real estate is always treated as passive regardless of any professional-status election

D. Yes, but only if Perpetua also personally owns at least five separate rental properties

100. Investor Bartholomew Quince sells his entire interest in a passive rental real estate activity to an unrelated buyer under the installment method, recognizing gain ratably as installment payments are received over five years. The activity carries $50,000 of suspended passive activity losses. How are these suspended losses treated?

A. They are fully deductible against nonpassive income in the year of sale, regardless of gain recognized

B. They are permanently disallowed because installment sales do not constitute a fully taxable disposition

C. They become deductible in each year in proportion to the gain recognized from the installment payments that year

D. They may only be used to offset future passive income from other unrelated passive activities

Answer Key and Explanations — Practice Exam 26, Part 2: Businesses

1. D — Under the cash method, gross income is reported in the year actually or constructively received, without regard to when related services are performed; deferral provisions for advance payments apply only to accrual-method taxpayers. Wendell must include the full $9,000 retainer in current-year Schedule C income under Section 451, even though services continue into the following year.

2. B — An executor's fee is subject to self-employment tax only when the individual is in the trade or business of serving as a fiduciary. An isolated, nonrecurring executor role unrelated to Sandra's regular occupation produces ordinary income reportable on Schedule 1, not Schedule C, and is excluded from net earnings from self-employment under Section 1402.

3. C — The home office deduction, under either the actual-expense or simplified method, is allowed only for the portion of the year the space actually met the exclusive-and-regular-use test. Because Lucas's room qualified for four months, his deduction, whether computed as square footage times $5 or as prorated actual expenses, must be limited to that four-month period, not the full year.

4. A — A partner's own unfunded promissory note is not "property" for Section 721 purposes; because no cash or other value has actually changed hands, contributing it produces no immediate basis increase. Elin's outside basis rises only as principal payments are actually made, preventing partners from claiming basis for a mere unfulfilled promise to contribute capital later.

5. A — Under Section 752, a partnership's recourse liability is allocated to the partner who bears the economic risk of loss for that debt, typically the general partner responsible for satisfying it if the partnership cannot pay. Because only Wilhelmina bears this risk, the entire $80,000 liability increases her outside basis, not the limited partners' bases.

6. C — Guaranteed payments are treated under Section 707(c) as if made to a non-partner; satisfying one with appreciated property is treated as a taxable exchange rather than a Section 731 distribution. Brackenridge Partners must recognize the $25,000 built-in gain, $40,000 fair market value minus $15,000 basis, and Ingrid separately reports $40,000 of ordinary income for her services.

7. B — Section 743(d) requires a partnership to make a mandatory downward basis adjustment when a transferred interest carries a substantial built-in loss, generally more than $250,000, even without a Section 754 election in effect. This mandatory rule prevents the incoming partner from later claiming inflated deductions or losses tied to the pre-transfer built-in loss.

8. D — Section 751(c) expressly defines unrealized receivables to include the amount that would be Section 1245 or 1250 depreciation recapture if the partnership sold its property at fair market value. Even without any billed receivable, this recapture potential qualifies as a hot asset, so Yusra must recharacterize the corresponding portion of her sale gain as ordinary income.

9. A — A Section 754 election is made by attaching a written statement to a timely filed partnership return, including extensions, for the year the sale, exchange, or death occurs. Once validly made, it binds the partnership going forward, applying to every future transfer and distribution, not merely the triggering event, until the partnership obtains IRS consent to revoke it.

10. D — When a partnership allocation lacks substantial economic effect, Section 704(b) requires the item to be reallocated according to the partners' interests in the partnership, a facts-and-circumstances standard weighing contributions, economic profit and loss sharing, cash-flow rights, and liquidation entitlements, rather than defaulting to equal shares or the stated but disregarded contractual percentages.

11. B — A partnership's Form 1065 is generally due the 15th day of the third month after the close of its tax year; when a partnership terminates under Section 708(b)(1) mid-year, that short tax year closes on the termination date. Because Larkhaven terminated on June 10, its final return is due September 15, absent a timely filed extension request.

12. C — Family partnership rules under Section 704(e) examine whether a minor donee is the real owner of a gifted interest; an independent custodian who exercises genuine fiduciary discretion, rather than the donor-parent retaining control, satisfies this requirement. Because Desmond acts independently of Emmeline, Julian's capital interest is respected, unlike arrangements where the donor-parent keeps effective control over the gifted interest.

13. D — Loss limitations for partners apply sequentially: the Section 704(d) basis limitation first, then the Section 465 at-risk limitation, and finally the Section 469 passive activity loss rules, each tested only against the amount surviving the prior limitation. Chidi's $9,000 loss is capped at $6,000 by basis, then further capped at $4,000 by at-risk, before passive rules even apply.

14. A — Under the material participation regulations, an individual who is both a general partner and a limited partner in the same partnership is not confined to the restrictive tests that apply to pure limited partners; any of the seven standard tests may be used. Because Astrid's 180 hours satisfy one such test, her distributive share from Hollowbrook is nonpassive income.

15. B — Business meals with clients or prospective clients remain subject to the general 50% deduction limitation under Section 274(n), provided the expense is ordinary, necessary, and not lavish or extravagant. Unlike entertainment expenses, made entirely nondeductible by the Tax Cuts and Jobs Act, properly substantiated business meals still qualify for the 50% deduction, capping Odalys's deduction at $90.

16. C — Section 737 requires a contributing partner who receives other partnership property, not the property he originally contributed, within the mixing-bowl period to recognize gain, limited to the partner's remaining net precontribution gain. This differs from Section 704(c)(1)(B), which instead applies when the partnership distributes that same originally contributed property to a different partner within the same period.

17. C — Renters compute the actual expense home office deduction the same way homeowners do, applying the business-use percentage to indirect expenses, except that rent replaces the depreciation deduction a homeowner would otherwise claim on the residence. Colton multiplies his rent and other qualifying household costs by his office's business-use percentage rather than depreciating a home he does not own.

18. B — Under Section 723, a partnership's basis in property contributed by a partner equals the contributing partner's adjusted basis immediately before the contribution, carried over rather than stepped up to fair market value. Northgale Partners therefore takes a $45,000 basis in the equipment, preserving the $25,000 built-in gain for later recognition under Section 704(c).

19. D — Section 1244 allows an ordinary loss deduction, rather than capital loss treatment, for qualifying small business stock that becomes worthless, capped annually at $50,000 for single filers and

$100,000 for a married couple filing jointly. Corwin's $120,000 loss is ordinary up to $100,000, with the remaining $20,000 treated as an ordinary capital loss instead.

20. A — Courts weigh factors such as a fixed maturity date, a stated interest rate, an unconditional repayment obligation, reasonable debt-to-equity ratios, and proportionality to stock ownership when distinguishing debt from equity. Subordinated, proportional advances repayable only from profits and lacking formal documentation resemble equity. A genuine note with defined repayment terms, as in Option A, supports bona fide debt treatment.

21. B — Section 531 imposes a corporate-level accumulated earnings tax on C corporations that retain earnings beyond the reasonable needs of the business, primarily to shield shareholders from individual tax on dividends. The tax is assessed against Greywick itself, not its shareholders, and applies regardless of whether Greywick is otherwise a widely or closely held corporation.

22. D — Section 6655 generally allows a corporation to avoid the estimated tax underpayment penalty by paying installments equal to the lesser of 100% of the current year's tax or 100% of the prior year's tax, provided the prior year covered a full 12 months and the corporation is not a large corporation. Halveston satisfies this prior-year safe harbor.

23. C — Beyond the five-year active trade or business requirement, Section 355 also requires that the spin-off not be used principally as a device for distributing the earnings and profits of either corporation to shareholders in a manner resembling a taxable dividend. Satisfying the device test is essential for Northcastle's distribution to remain fully tax-free.

24. A — Section 1361(c)(1) permits members of a family to be treated as a single shareholder for the 100-shareholder limit. A family consists of a common ancestor and all lineal descendants of that ancestor within six generations, along with their spouses and former spouses. This lets closely related shareholders like Whitcombe and his grandson count as one shareholder for eligibility purposes.

25. B — Under Section 1367, when a shareholder's reduced-basis loan to an S corporation is repaid, gain is recognized to the extent the repayment exceeds the shareholder's remaining debt basis. Brennan's debt basis is $4,000, so the $6,000 repayment produces $2,000 of taxable income, generally capital gain for an open-account or bona fide note, before any debt basis restoration.

26. C — Under the AAA ordering rules, current-year income and loss items adjust AAA before distributions are taken into account, and a distribution can reduce AAA to zero but never below zero. Sable Ridge's $18,000 AAA is reduced by the $30,000 loss to a negative balance for loss-absorption purposes, but the distribution itself cannot drive the reported AAA below zero.

27. A — Under Section 1375(d), an S corporation with accumulated C corporation earnings and profits that has passive investment income exceeding 25% of gross receipts for three consecutive tax years automatically loses its S election, effective the first day of the following tax year, regardless of whether the corporation intended or wanted this result to occur.

28. D — Under Reg. Section 301.7701-3(f)(2), when a disregarded entity's ownership changes so that it has more than one owner, its default classification automatically changes from disregarded entity to partnership, effective on the date of the ownership change, with no new election required unless the members affirmatively elect corporate treatment on Form 8832.

29. B — Converting a C corporation into an LLC by distributing its assets to the shareholder is treated as a complete liquidation under Sections 331 and 336. The corporation recognizes gain or loss as if it sold the assets at fair market value, and the shareholder recognizes gain or loss on the deemed exchange of stock, producing two levels of tax.

30. C — Under Section 707(c), a payment to a partner for services, determined without regard to partnership income, is a guaranteed payment. Briarcombe deducts the $4,000 monthly payment as a business expense, and Duarte reports it as ordinary income, generally subject to self-employment tax, separate from her distributive share of any remaining partnership profit or loss.

31. D — The IRS applies a guideline, reflected in Rev. Proc. 77-37, treating property transfers by a transferor whose stock is worth less than 10% of the value of stock already held or received by accommodating transferors as potentially not counting toward the Section 351 control test if the primary purpose is to qualify other transferors, jeopardizing the group's 80% control requirement.

32. A — The Inflation Reduction Act created a 15% corporate alternative minimum tax under Section 55 applicable to "applicable corporations," generally those with average annual adjusted financial statement income exceeding $1 billion over a three-year testing period. Solmera's income level triggers this minimum tax, which is computed on book income rather than regular taxable income.

33. B — For premiums paid to a captive insurer to be deductible as insurance expense, the arrangement must involve genuine risk shifting away from the insured and adequate risk distribution across a sufficient pool of independent risks. A captive that insures only its own parent and affiliates, without spreading risk among unrelated parties, may fail this test and be recharacterized.

34. C — Section 304 treats a sale of stock in one commonly controlled corporation to a related corporation as a redemption of the acquiring corporation's own stock, tested under Section 302's dividend-versus-exchange framework using constructive ownership rules. Because Cordelia controls both entities, her sale to Thistlecroft is recast as a redemption rather than a simple stock sale.

35. A — Section 1402(a)(13) exempts a limited partner's distributive share from self-employment tax, but courts and the IRS look past the LLC label to the member's actual functional role. An LLC member who actively manages operations, like Tamsin, is generally treated as a general partner equivalent, so her distributive share remains subject to self-employment tax.

36. D — Under Section 61 and the regulations, a taxpayer performing services who is paid in property, rather than cash, must include the fair market value of the property received in gross income, not the payor's original cost basis. Garrick includes $9,500, the van's fair market value at receipt, which also becomes his basis in the van going forward.

37. B — Under FIFO, the earliest-purchased units are treated as sold first, so ending inventory consists of the most recently purchased units. Emberton sold all 200 March units plus 50 September units, leaving 250 September units at $13 each on hand: 250 times $13 equals $3,250, the correct FIFO ending inventory value reported.

38. D — Under Section 448(b)(2), the gross receipts limitation restricting C corporations to the accrual method does not apply to qualified personal service corporations. Because Marchetti & Vale is substantially employee-owned and performs services in a qualifying field, law, it may continue using the cash method regardless of its gross receipts level.

39. C — A hybrid method combining accrual for inventory items with cash for other income items is permissible only if it clearly reflects income and is applied consistently from year to year, per Reg. Section 1.446-1(c)(1)(iv). Thistlewood's approach is acceptable because merchandise sales, which require accrual, are properly separated from its cash-basis items.

40. A — A Section 444 election allowing a deferral period without an established business purpose requires the corporation to make a required payment under Section 7519, approximating the value of the tax deferral shareholders receive. This payment, computed annually on Form 8752, must be made and maintained or the fiscal year election terminates automatically.

41. B — Section 460(e) excepts home construction contracts and contracts of small contractors meeting the average annual gross receipts threshold from the percentage-of-completion requirement, permitting use of the completed-contract or another exempt method instead. Because Duskwood satisfies the small contractor exception for this home construction contract, it may use the completed-contract method.

42. C — Section 1031(f) generally requires related parties to hold like-kind exchange property for at least two years after the exchange; disposing of it sooner causes both related parties to recognize the gain or loss originally deferred, measured as of the date of the early disposition. Granton's nine-month holding period falls well short of that requirement.

43. D — Section 1033(g) grants an extended three-year replacement period, measured from the close of the tax year in which gain is first realized, for condemned real property held for productive use in a trade or business or for investment. This is longer than the standard two-year period applying to most other involuntary conversions generally.

44. A — Under Rev. Proc. 2015-13, a taxpayer voluntarily changing its accounting method with a resulting positive Section 481(a) adjustment generally spreads that adjustment ratably into income over four tax years beginning with the year of change. A negative adjustment, by contrast, is deducted entirely in the year of change, without any multi-year spread required.

45. B — Section 460 applies only to long-term contracts for the manufacture, building, installation, or construction of property. Contracts limited to engineering or architectural services, without an accompanying construction or manufacturing component, are excluded from Section 460's scope entirely and instead follow Northgate's regular overall method of accounting for reporting income and expenses.

46. D — Under the claim-of-right doctrine established in North American Oil Consolidated v. Burnet, a taxpayer with unrestricted control over funds received must include them in gross income when received, even though the right to retain them is disputed and repayment might later be required. Any eventual repayment is addressed in the year it occurs, often under Section 1341.

47. C — Under the simplified resale method, additional Section 263A costs are capitalized by multiplying the absorption ratio, additional costs divided by total inventory costs, by the ending inventory balance before adjustment. Here, 0.4% times $500,000 equals $2,000, the additional purchasing-related cost Marrow must capitalize to ending inventory rather than currently deduct as an expense.

48. A — A taxpayer using LIFO for tax purposes must value inventory strictly at cost and may not also apply the lower of cost or market method, unlike taxpayers using FIFO. Combining LIFO with lower of cost or market valuation is not permitted under the regulations, so Anchorpoint must value its entire LIFO inventory at cost only.

49. A — Section 453A(d) treats the net proceeds of a loan secured by a pledge of an installment obligation as a payment received on that obligation, accelerating recognition of the deferred gain. This pledge rule prevents taxpayers holding large installment obligations from indefinitely deferring gain simply by borrowing against the note instead of collecting it.

50. B — Section 472(c)'s LIFO conformity requirement generally bars a taxpayer from using any inventory method other than LIFO, or a method clearly permitted as consistent with LIFO, in financial statements issued to shareholders, creditors, or for credit purposes, once LIFO is elected for tax purposes. Ravensworth must maintain consistency between its tax and financial reporting.

51. D — Qualified improvement property, meaning improvements made to the interior of a nonresidential building already placed in service, excluding enlargements, elevators, escalators, and structural framework changes, is 15-year MACRS property eligible for bonus depreciation under current law. Blackthorn's interior renovation qualifies for this favorable classification rather than the building's own 39-year recovery period.

52. C — Land improvements such as paving, fencing, and drainage systems are 15-year MACRS property under Asset Class 00.3, depreciated separately from both the underlying land, which is never depreciable, and the building, which recovers over 39 years. Castellan therefore depreciates the parking lot and drainage system on its own 15-year recovery schedule.

53. B — Section 179(b)(3) caps the current-year deduction at aggregate business taxable income; any amount disallowed for lack of income is not lost but carries forward indefinitely under Section 179(b)(3)(B) until the taxpayer has sufficient business income to absorb it, distinct from the separate dollar and phase-out limitations under Section 179(b)(1) and (b)(2).

54. D — Section 195 allows a taxpayer to currently deduct up to $5,000 of start-up expenditures in the year business begins, phased out dollar-for-dollar once total start-up costs exceed $50,000, with any remaining amount amortized ratably over 180 months beginning with that month. Ellendale's $8,000 in costs falls within this deduct-and-amortize framework.

55. C — Under Section 280F(b), listed property must be used more than 50% for business purposes during the tax year to qualify for accelerated MACRS depreciation and Section 179 expensing. If the predominant-use test is not exceeded, Thornfield must instead use the straight-line alternative depreciation system over the drone's ADS recovery period.

56. A — Section 197 generally applies only to intangibles acquired in connection with acquiring a business or its assets, not to self-created intangibles. Quillon's internally developed customer list falls outside Section 197's scope entirely, and its treatment instead depends on ordinary deduction and capitalization rules governing the marketing costs incurred to create it.

57. D — Section 45A computes the Indian employment credit as 20% of the excess of current-year qualified wages and health insurance costs paid to qualified employees over the corresponding amounts paid in a base year, subject to a per-employee wage cap. Thornquist's credit is calculated using this incremental formula rather than a flat percentage of total payroll.

58. C — Section 51 reduces the Work Opportunity Tax Credit rate to 25% of qualified first-year wages when a targeted-group employee works at least 120 but fewer than 400 hours. The full 40% rate applies only once the employee reaches 400 hours; fewer than 120 hours worked disqualifies the wages entirely from any credit.

59. B — Section 41(d)(4) specifically excludes research conducted after the beginning of commercial production of the product or process from the statutory definition of qualified research. Granton's routine post-production quality-control testing no longer involves resolving technical uncertainty through a genuine process of experimentation, so these costs generate no research credit benefit whatsoever.

60. A — Section 44(b) defines an eligible small business as one whose gross receipts did not exceed $1,000,000, or that had no more than 30 full-time employees, in the preceding tax year. Brindlewood must satisfy either prong of this test before it may claim the Disabled Access Credit on its qualifying access expenditures.

61. A — Section 199A(d)(2) defines the field of health broadly to include businesses where the principal asset is the skill or reputation of practitioners providing medical or health-related services directly to clients. Ophira's licensed practitioners performing supervised counseling and treatment services fall squarely within this SSTB category, triggering the income-based phase-out limitation for high-income owners.

62. D — Section 199A(b)(1)(B) provides a separate 20% deduction for combined qualified REIT dividends and qualified PTP income. Unlike QBI from a trade or business, this component is never subject to the W-2 wage/UBIA limitation or the SSTB exclusion, regardless of the taxpayer's taxable income level, and is computed independently before combining totals.

63. C — For taxpayers fully above the phase-in range, Section 199A(b)(2) limits the QBI component to the greater of 50% of W-2 wages or 25% of W-2 wages plus 2.5% of UBIA of qualified property. Here, 25% of $40,000 plus 2.5% of $600,000 equals $25,000, exceeding 50% of wages, so $25,000 applies.

64. B — Section 45R allows a maximum credit of 50% of premiums paid by a taxable eligible small employer purchasing coverage through the SHOP Marketplace, compared to only 35% for tax-exempt eligible small employers. The credit phases out as the employer's average annual wages rise and as full-time equivalent employees exceed ten total.

65. C — Under the half-year convention of Section 168(d)(1), property is treated as disposed of at the midpoint of the tax year regardless of the actual sale date. Dunmore therefore claims one-half of the full-year depreciation amount otherwise allowable for that recovery year, whether the equipment was sold in January or in December.

66. B — Only employers the IRS has designated as Form 944 filers may use it; the IRS typically notifies qualifying employers in writing based on an estimated annual liability of $1,000 or less. An employer expecting to qualify but not yet notified must contact the IRS to request permission before filing Form 944 instead of quarterly Forms 941.

67. D — A worker or the firm may file Form SS-8 asking the IRS to formally determine whether a worker is a common-law employee or an independent contractor. The IRS reviews the facts presented and issues a determination letter. Form 8919 is used later, only after such a determination, to report the worker's uncollected FICA share.

68. A — When supplemental wages paid separately from regular wages total $1 million or less for the year, and income tax was withheld from the employee's regular wages, an employer may use the optional flat rate of 22 percent under the regulations, regardless of the employee's Form W-4 withholding elections for regular pay.

69. B — Under the accountable plan regulations, reimbursements are excluded from an employee's wages only if the arrangement requires a business connection to the expense, adequate substantiation of amount, time, place, and business purpose within a reasonable period, and the return of any excess reimbursement. Bellhurst's arrangement must satisfy all three elements to avoid payroll tax withholding.

70. D — Section 45B allows food and beverage employers a general business credit for the employer share of FICA tax paid on employee tips that exceed the portion needed to bring cash wages up to the frozen $5.15 hourly rate used for this calculation, encouraging accurate employee tip reporting without reducing reported income.

71. A — Treasury Regulation 1.274-5 requires a taxpayer to substantiate the amount, time, place, and business purpose of a travel expense, along with the business relationship to any person entertained or dealt with, through adequate contemporaneous records or sufficient corroborating evidence. Thaddeus must document each of these five elements for his travel expense to be deductible.

72. C — Section 280A(c)(1) requires a home office to be used both exclusively and on a regular, continuing basis for business. Exclusive use alone is not enough — sporadic, incidental use, even in space never used for anything personal, fails the separate regular-use requirement, so Desmond's infrequent two-afternoons-a-month usage pattern disqualifies the space entirely.

73. C — The standard mileage rate is unavailable to a taxpayer who operates five or more vehicles simultaneously, such as in a fleet operation. Because Petra uses six vehicles at the same time in her delivery business, she must use the actual expense method for each vehicle instead of the standard mileage rate.

74. B — When a leased vehicle's fair market value exceeds the luxury automobile threshold, the lessee must include an annual lease inclusion amount, taken from IRS tables and prorated for business-use percentage, in gross income each year. This offsets the deduction advantage leasing would otherwise have over purchasing a comparably priced vehicle outright.

75. D — Treasury Regulation 1.274-5T permits a taxpayer to substantiate business vehicle use through a sampling method, using detailed records for only a representative portion of the year rather than a complete contemporaneous log for every single day, as long as the sampled period fairly and reasonably reflects the taxpayer's overall business-use pattern.

76. A — The Social Security wage base is a single annual limit applied across all wages and self-employment earnings combined for one taxpayer. Because Simon's $150,000 of W-2 wages already used most or all of the wage base, little or none of his $40,000 in net self-employment earnings remains subject to the Social Security portion.

77. A — Section 3406 requires a payer to begin backup withholding, at the statutory flat rate, on reportable payments made to a payee who fails to furnish a correct taxpayer identification number after being properly requested to do so. Osbert must withhold from future payments to Owen and remit the withheld amounts to the IRS accordingly.

78. D — Section 6672 imposes a trust fund recovery penalty personally on any responsible person who willfully fails to collect, account for, or pay over withheld employment taxes. Because the CFO controlled the funds and knowingly diverted them instead of remitting them, the IRS may assess the penalty directly against the CFO individually, not just the corporation.

79. C — An employer must withhold Additional Medicare Tax once an employee's wages from that employer alone exceed $200,000 in the calendar year, regardless of the employee's filing status, marital status, or income from other sources. Reconciliation with the employee's actual liability, based on combined household income, occurs on the employee's individual return.

80. B — Form 56 notifies the IRS under Section 6903 that a fiduciary relationship exists, authorizing the fiduciary to act for the estate or trust and receive notices on its behalf. It should be filed when the relationship begins and again when it terminates. Form 2848 authorizes representatives, not fiduciaries, and cannot substitute for this notice.

81. C — Section 642(b) allows a $600 exemption for an estate, $300 for a simple trust required to distribute all income currently, and $100 for a complex trust that may accumulate income or make discretionary corpus distributions. Unlike the suspended personal exemption for individuals under current law, these fiduciary exemption amounts were unaffected by the Tax Cuts and Jobs Act.

82. D — Under Section 167(d) and typical state fiduciary accounting law, a depreciation deduction is apportioned between the trust and its income beneficiaries based on their respective shares of trust accounting income, unless the governing instrument requires a different allocation or a specific reserve. Silence in the instrument defaults to this proportional, income-based apportionment method.

83. B — Section 674 treats the grantor as owner of a trust when the power to control beneficial enjoyment of income or corpus rests with a person lacking a substantial adverse interest, such as an independent trustee with unrestricted sprinkling discretion. Because no adverse party holds this power, Petra remains taxable on all trust income regardless of actual distributions made.

84. A — Estates, unlike most trusts, are not required to adopt a calendar year for income tax purposes. The executor may elect any fiscal year-end for the estate's first Form 1041, provided the initial tax period runs no longer than twelve months from the date of death, allowing flexibility in timing income and deductions.

85. D — Under Section 663(a)(1), a bequest of a specific sum of money or specific property, paid outright in three or fewer installments under the governing instrument, is excluded from the income distribution deduction and does not carry out DNI. The grandchild receives the bequest tax-free, and the estate remains taxable on that retained DNI.

86. C — Section 513(i) excludes qualified sponsorship payments from unrelated business taxable income when the exempt organization merely acknowledges the sponsor's name, logo, or product lines without providing advertising, such as price comparisons, qualitative endorsements, or calls to action. Because the banner display is mere acknowledgment rather than advertising, the $40,000 payment is excluded from UBTI.

87. A — Section 513(d) excludes income from qualified convention and trade show activities conducted by a tax-exempt organization in conjunction with its annual meeting, where the activity educates members and the public about industry developments. Because the trade show serves this traditional educational function of the meeting, the booth rental income is excluded from unrelated business taxable income.

88. B — Section 4943(c)(6) grants a private foundation a five-year period, running from the date it receives business holdings by gift, bequest, or similar transfer, to dispose of holdings exceeding the permitted excess business holdings limit before the initial excise tax accrues. The IRS may grant a limited additional period in unusually difficult disposition cases.

89. D — A Section 509(a)(2) organization must meet a two-part support test: normally more than one-third of support from public sources and program service revenue, and no more than one-third of support from gross investment income and unrelated business taxable income combined. Section 509(a)(1) organizations are not subject to this separate investment income ceiling.

90. B — An exempt organization's unrelated business income tax is computed using the rates applicable to its underlying organizational form: a corporation applies the flat corporate tax rate, while a trust applies the compressed individual trust rate brackets. Both remain subject to the $1,000 specific deduction, but the rate schedule used to compute the actual tax owed differs by entity type.

91. C — An employer generally may establish a SIMPLE IRA plan only if it had no more than 100 employees who received at least $5,000 in compensation during the preceding calendar year. With 85 qualifying employees, Wrenfield satisfies this eligibility threshold and may adopt a SIMPLE IRA plan for the upcoming year without exceeding the statutory limit.

92. A — The SECURE Act allows an employer to adopt a new qualified retirement plan, other than a SIMPLE plan, as late as the due date of its business tax return, including extensions, and still treat the plan as adopted retroactively for the prior year for deduction purposes. SIMPLE IRA plans generally still require adoption by October 1.

93. C — The ratio percentage test under Section 410(b) is satisfied when the percentage of non-highly compensated employees covered by the plan equals at least 70% of the percentage of highly compensated employees covered. This minimum coverage test operates separately from the ADP and ACP nondiscrimination tests, which measure contribution or deferral rates rather than plan eligibility.

94. B — Section 411(d)(3) requires that, upon full or partial termination of a qualified plan, all affected participants become 100% vested in their accrued benefits regardless of the plan's original vesting schedule. This rule protects employees from forfeiting benefits solely because the employer discontinues the plan before their vesting requirements were otherwise satisfied under its terms.

95. A — Elected farm income under Section 1301 includes income from a farming business, including gain from selling property regularly used in the farming business for a substantial period, such as livestock or equipment. Gain from selling the farmland itself is not attributable to the farming business in this sense and cannot be included in farm income averaging.

96. D — Section 447 generally requires C corporations engaged in farming to use the accrual method, but it carves out an exception for family farming corporations meeting specified family-ownership requirements, allowing them to continue using the cash method regardless of gross receipts. This preserves cash-method flexibility for closely held family farm operations organized in corporate form.

97. B — Section 451(d) treats Noninsured Crop Disaster Assistance Program payments the same as federal crop insurance proceeds for deferral purposes. A cash-method farmer may elect to defer proceeds attributable to crop damage occurring in the current year to the following year, but the election must apply uniformly to all such payments received for that damaged crop.

98. D — Because straight-line depreciation produces no ordinary-income recapture under Section 1250 itself, the depreciation-attributable portion of the gain is instead taxed as unrecaptured Section 1250 gain, capped at a maximum federal rate of 25% rather than the taxpayer's ordinary rate or the standard long-term capital gain rates that otherwise apply to real property sales.

99. A — Section 469(c)(7) exempts a qualifying real estate professional's rental real estate activities from automatic passive treatment if the taxpayer performs more than 750 hours and more than half of all personal service hours for the year in real property trades or businesses with material participation. Perpetua's 900 hours easily satisfies both prongs of this test.

100. C — A sale of a passive activity to an unrelated party is a fully taxable disposition under Section 469(g), freeing suspended losses, but when the gain is reported under the installment method, the suspended losses are released proportionately, matching the percentage of gain recognized in each year installment payments are received, rather than all released immediately at once.