

2002

SPECIAL ENROLLMENT
E X A M I N A T I O N



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PART 3

**SPECIAL ENROLLMENT
EXAMINATION BOOKLET**

**SEPTEMBER 26, 2002
9:00 A.M. TO 12:00 NOON**

**Corporations
(Including S Corporations),
Fiduciaries, Estate and
Gift Tax, and Trusts**

*Official Use Only
(Declassified After September 26, 2002)*

Special Enrollment Examination

Part 3

Corporations (Including S Corporations), Fiduciaries, Estate and Gift Tax, and Trusts

Instructions:

The time allotted for this part of the examination is 3 hours. No additional time will be granted. On your answer sheet in the spaces provided you should enter the following:

1. Print your name (First, M.I., Last).
2. Sign your name (First, M.I., Last).
3. Place of examination (City and State).
4. Date of this examination.
5. Print your name (Last, F.I., M.I.) in the boxes provided. Immediately below the boxes darken the oval corresponding to the letter you have printed, as in the sample Name Grid. Darken only one oval in each column below a box in which you have printed a letter. Make no marks in the columns below boxes you have left blank.
6. Enter your candidate number and immediately below, darken the oval corresponding to each number you have entered.
7. Enter your Social Security Number and immediately below, darken the oval corresponding to each number you have entered.

Important:

The answer sheet should not be folded or torn since it will be machine graded.

Read the examination questions carefully. All references are to the Internal Revenue Code as amended through December 31, 2001. Unless otherwise stated, all questions relate to the calendar year 2001.

You will be given a No. 2 pencil by the monitor. Darken completely only one oval under the corresponding letter on the answer sheet. In making corrections, erase

errors completely. You will be allowed to keep your examination question books after completion of the examination. Scratch paper will be provided, but you may make necessary computations in the question books. Raise your hand to attract the monitor's attention when you need extra supplies or for permission to leave the room.

When you finish the examination, your answer sheet must be turned in to the monitor before leaving the room. You must turn in your answer sheet at the end of each test session or your test will not be graded and no credit received. **Answers noted in examination booklets will not be graded.** The examination will be graded in Washington, D.C., by the Office of Professional Responsibility, Internal Revenue Service. You will receive formal notification of your examination results on or about January 31, 2003.

General Grading Information:

The questions in this examination have been assigned values of 1 to 3 points. All true or false questions have a value of 1 point each; the multiple choice questions in Section B have a value of 2 points each; and the multiple choice questions in Section C have a value of 3 points each.

The examination is graded on the basis of correct answers. If more than one oval is darkened in answering a question, the answer will be considered incorrect.

The Service will include the answers with your formal notification of examination results. Therefore, you may want to mark your answers in this examination question book and retain it for purposes of your future comparison.

Part 3

Section A:

Questions 1 – 20

The following statements are either true or false. Select the most appropriate answer and darken the oval under A for True or B for False.

1. Unless specifically elected otherwise using Form 8832, a single member limited liability company will be classified as a corporation for Federal income tax purposes.
2. If you transfer property (or money and property) to a corporation solely in exchange for stock in that corporation (other than nonqualified preferred stock) and immediately thereafter you are in control of the corporation, the exchange is usually **not** taxable.
3. If a corporation cancels a shareholder's debt without repayment by the shareholder, the amount canceled is treated as a distribution to the shareholder.
4. If the Richards Corporation, a C corporation carries its capital losses from two or more years to the same year, the loss for the earliest year is deducted first. When that loss is completely absorbed, the loss from the next earliest year is then deducted, and so on.
5. Generally, a corporation must make estimated tax payments if it expects its income for the year to be \$500 or more.
6. As long as 100% of the stockholders of a Corporation elect, in writing, to adopt Subchapter S status for their Corporation, generally such election will be valid for the current tax year if it is properly requested within 180 days of the start of the corporation's tax year.
7. An S Corporation is permitted to own a qualified Subchapter S subsidiary.
8. On January 1, 2001, Harbor, Inc., a calendar year S Corporation had three shareholders (Bob, Dave, and John). Bob owned 50% of the stock, while Dave and John each owned 25%. On July 1, 2001, Bob sold his stock equally to Dave and John. If at the end of the tax year the corporation has a net operating loss, and Dave and John's basis in their stock is sufficient, 50% of the net operating loss will flow through to Dave and 50% of the net operating loss will flow through to John.
9. Mary is the president of Should-A-Thought, Inc., a C-Corporation. She owns 48% of the corporate stock. From inception in 2000, the company has lost money. She feels that the company will continue to be unprofitable for the next 3-5 years. She wants to convert to an S Corporation to take advantage of the prior losses. If Should-A-Thought, Inc. timely files the proper form to elect to be an S Corporation prior losses of the company will flow through to Mary's personal income tax return.
10. The decedent was a cash basis taxpayer who had chosen not to report the interest each year from his series EE savings bonds that he purchased during his lifetime. The executor of his estate may elect to include on the decedent's final return all of the interest earned on the bonds before the decedent's death.
11. Payments received on an inherited installment obligation are never taxable to the beneficiary.
12. A carryover NOL that is passed through to a beneficiary is deducted on the beneficiary's return as a miscellaneous itemized deduction **not** subject to the 2% floor.
13. An estate tax return (Form 706) must be filed within 6 months after the date of the decedent's death, unless an extension of time to file is requested.
14. If an individual transfers title to property to one or more other individuals, but retains the right to the use of the property during his or her lifetime, the property will be included in his or her estate.
15. A decedent's funeral expenses may be taken as a deduction on Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return.
16. Forrester gave his son \$20,000 in stock that he had inherited from his father. His wife, Martha, gave no gifts during the year. Forrester is not required to file a gift tax return for the year of the gift.
17. A \$20,000 gift to an unrelated individual who is 40 years younger than the donor is subject to both the gift tax and the generation-skipping transfer tax.
18. A trust that is required to distribute all of its income currently, is always classified as a simple trust.

19. The income of a grantor trust is reported on the grantor's return even if no distributions from the trust are made to the grantor.
20. A simple trust must file a tax return if it has gross income for the year of \$600 or more.

Turn to the next page for Part 3, Section B.

Part 3

Section B:

Questions 21 - 45

The following questions are multiple choice. Select the most appropriate answer and darken the oval under the corresponding letter on the answer sheet.

21. Which of the following types of domestic business entities, formed after 1996, must be taxed as a corporation?

1. An association.
 2. An insurance company.
 3. Any business formed under state law that refers to itself as a corporation.
 4. A single member limited liability company.
- A. All of the above.
B. 1, 2 and 3 only.
C. 3 only.
D. 2 and 3 only.

22. John and Jim each own 5% of J&J Partnership, which was founded in 1990. J&J is a calendar year taxpayer. On March 20, 2002, they elected to be treated as a corporation for Federal tax purposes by filing a Form 8832. What is the earliest date that J&J can be treated as a corporation?

- A. January 1, 2002.
B. March 20, 2002.
C. January 4, 2002.
D. January 1, 2003.

23. ABC Company, a corporate taxpayer, has a fiscal year ending September 30. The due date, excluding extension, for filing their return is:

- A. January 15.
B. November 15.
C. December 1.
D. December 15.

24. Which of the following statements about a controlled group of corporations is true?

- A. Members of a controlled group are entitled to only one accumulated earnings tax credit.
B. A parent corporation and its 80% owned subsidiary make up a controlled group.
C. All members of a controlled group need not use the parent's tax year.
D. All of the above.

25. Which of the following costs qualify as business "start-up costs"?

- A. Deductible interest.
B. State and local taxes.
C. A survey of potential markets.
D. Research and experimental costs.

26. Which of the following costs would qualify as business "organizational costs"?

- A. State incorporation fees.
B. State and local taxes.
C. Deductible interest.
D. None of the above.

27. Which of the following is an example of nonqualified preferred stock in a Section 351 transaction?

- A. The holder of the stock has the right to require the issuer or a related person to redeem or buy the stock.
B. The issuer of the stock is required to redeem or buy the stock.
C. The dividend rate on the stock varies with reference to interest rates, commodity process, or similar indices.
D. All of the above.

28. Acme Corporation made payments during the year that are required to be reported to the IRS and the recipients on Form 1099-DIV in paper format. What are the due dates to file Form 1099-DIV?

<u>Filing date to IRS</u>	<u>Filing Date to Recipients</u>
A. February 28	January 31
B. January 31	January 31
C. March 15	March 15
D. None of the above	

29. The Smart Corporation distributes an office building to Collin, a shareholder of the corporation. The fair market value of the building exceeds its basis to the corporation. Which of the following statements is true with regard to this transaction?

- A. Smart Corporation realizes but does not recognize gain on this distribution.
B. Smart Corporation elects not to report the gain on this distribution.
C. Smart Corporation must recognize gain on this distribution.
D. Collin must recognize the losses on this distribution on his return as a shareholder.

30. Lantern Corporation is in the process of dissolving and has filed a request with the Internal Revenue Service (IRS) for a prompt assessment. Assuming all other requirements are met, if the request is granted, the period within which the IRS may assess a tax liability is shortened to how many months?

- A. 24 months.
B. 18 months.
C. 36 months.
D. 12 months.

- 31.** On January 1, 2001, Tom, Dick, and Harry were sole and equal shareholders of ABC, Inc., a calendar year C Corporation. On February 1, 2001, Tom sold all of his interest in the corporation to Dick. On March 1, 2001, Dick decides to convert the corporation to an S Corporation, effective January 1, 2001. Regarding the desired conversion, which of the following statements is true?
- A.** Since Dick now owns over 51% of the corporation, he can unilaterally prepare and submit the proper election application, IRS Form 2553.
 - B.** Since the S Corporation election requires consent by 100% of the shareholders, both Dick and Harry must sign the application to elect to be treated as an S Corporation.
 - C.** Since Tom, Dick, and Harry were all shareholders as of January 1, 2001, all three must consent to elect to treat the corporation as an S Corporation.
 - D.** Since there was a change in stock ownership after the beginning of the Corporation's tax year, any election to treat the corporation as an S Corporation will not be effective earlier than January 1, 2002.
- 32.** Previous years cash distributions to a shareholder have reduced his/her stock basis to zero in an S Corporation. How will any further cash distributions be treated for tax purposes if the company continues to have losses?
- A.** It will be treated as a deemed sale of the shareholder's stock.
 - B.** It will be treated as a capital contribution to the corporation.
 - C.** It will receive passive activity loss treatment, subject to any limitations.
 - D.** It will be carried over indefinitely to be offset with future earnings.
- 33.** On December 1, 2001, Bob elected to terminate his corporation's S status, effective January 1, 2002. Bob owns 55% of the corporation's stock. If Bob changes his mind, what is the earliest date that Bob could have his S Corporation status reinstated without IRS consent?
- A.** January 1, 2004.
 - B.** December 1, 2006.
 - C.** January 1, 2007.
 - D.** Since election to terminate S Corporation status requires 100% of the outstanding shareholders' consent, the revocation is not valid and the S Corporation qualifies until properly terminated.
- 34.** Allecia, a cash-basis taxpayer, died on July 15, 2001. Which of the following items of income are includible on her final return?
- A.** Dividends of \$20 that were declared on July 10 but not received in the mail until July 25.
 - B.** Interest of \$500 earned on a savings account through July 15, but not posted to the account until July 31.
 - C.** Consulting income of \$300. Allecia completed the job on July 2. The client mailed the payment on July 12, and the check arrived at Allecia's home on July 16.
 - D.** All of the above.
- 35.** Which of the following is **not** an example of income in respect of a decedent?
- A.** Wages earned before death, but unpaid at the time of death.
 - B.** A dividend check that was received by the decedent, but cashed after death.
 - C.** The taxable portion of an inherited IRA.
 - D.** The taxable portion of payments received on an inherited installment obligation.
- 36.** Mark died on December 22, 1999. The executor of his estate chose a calendar year. In 2000, the estate had a tax liability of \$2,000. It is expected that the estate will have an adjusted gross income of \$43,000 and a tax liability of \$3,000 in 2001. All of the income is from interest and dividends from which no tax was withheld. Which of the following statements regarding estimated tax payments for this estate are true?
- A.** The executor does not need to make estimated tax payments because the estate is only in its third year of existence.
 - B.** The executor should make equal estimated payments totaling at least \$2,000 (last year's tax liability) to avoid a penalty for underpayment of tax.
 - C.** The executor should make equal estimated payments totaling at least \$3,000 to avoid the penalty for underpayment of tax.
 - D.** Because the 2001 tax liability is no more than \$1,000 greater than the prior-year liability, no estimated tax payments are required.

37. On December 15, 2000, Kyle received a \$10,000 distribution from his father's estate. On March 30, 2001, Kyle was issued Schedule K-1 for the estate's first fiscal year (February 1, 2000, through January 31, 2001). The Schedule K-1 from the estate showed taxable interest income of \$200 and had no other entries. Based on the information above, which of the following statements are true?
- A. Kyle must report income of \$10,000 on his 2001 return.
 - B. Kyle must report \$200 interest income on his 2001 return.
 - C. Kyle may claim a deduction on Schedule A for a pro rata share of the estate tax that was paid by the estate.
 - D. Both B and C.
38. Which of the following items are included in a decedent's gross estate?
- The decedent's IRA, where the decedent's spouse is the named beneficiary.
 - A checking account with the decedent's daughter as joint tenants. The daughter's funds were used to set up the account.
 - Assets held in the decedent's revocable grantor trust.
- A. All of the assets are included in the decedent's estate.
 - B. The IRA and checking account are included in the decedent's estate.
 - C. The IRA and the assets in the revocable grantor trust are included in the decedent's estate.
 - D. None of the assets are included in the decedent's estate.
39. Which of the following items is **not** an allowable deduction on a decedent's estate tax return?
- A. Bequest to a surviving ex-spouse.
 - B. Property taxes accrued before death but not paid until after death.
 - C. Executor's fees for administering the estate.
 - D. None of the items is allowed as a deduction against the decedent's estate.
40. Which of the following statements concerning the alternate valuation election is correct?
- A. The alternate valuation election may be made even if no estate tax will be paid if the election is not made.
 - B. If the alternate valuation election is made, it is possible for some but not all of the assets to be included in the decedent's estate at a higher FMV than on the date of death.
 - C. If the alternate valuation election is made, assets that are disposed of within 6 months of the decedent's death are generally valued on the date of death.
 - D. None of the statements are correct.
41. The Ray Irrevocable Trust incurred a net operating loss (NOL) from normal business operations during its fourth, **non-final** year of existence. Ray's children are the income beneficiaries of the trust. Which of the following statements is correct concerning the (NOL)?
- A. The NOL is passed through to the beneficiaries and claimed on their returns.
 - B. The NOL is carried back, or if elected, carried forward, under the same rules for individuals.
 - C. The NOL is lost because excess deductions can only be passed through in the final year of a trust.
 - D. The NOL can only be claimed in the final year of the trust.
42. Which of the following statements regarding gift splitting is correct?
- A. The couple must have been married at the time the gift was given, but either or both spouses may be remarried during the year.
 - B. The couple must have been married at the time the gift was given and the spouse who gave the gift may not be remarried during the year.
 - C. The couple need not be married at the time of the gift, but must be married by the end of the year.
 - D. The couple must be married at all times during the year.

43. Edwin gave his grandson Todd \$30,000. Todd is 15 years old and lives with his parents. Which of the following statements regarding the generation-skipping transfer tax is true?
- A. Because the gift is subject to the generation-skipping transfer tax, it is **not** subject to the regular gift tax.
 - B. The gift is subject to both the regular gift tax and the generation-skipping transfer tax.
 - C. The gift is **not** subject to the generation-skipping transfer tax because Todd's parents are still alive.
 - D. If Edwin had transferred the funds into a trust solely for his grandson's benefit, the gift would **not** be subject to the generation-skipping transfer tax.
44. The Tom Trust requires that all trust income be distributed at least annually. There are no provisions for charitable contributions. To be treated as a simple trust, what must also be true?
- A. Trust income can consist of interest and dividends only.
 - B. There were no distributions of corpus in the current year.
 - C. All beneficiaries must be U.S. citizens or resident aliens.
 - D. All of the above
45. Which of the following statements regarding grantor trusts is true?
- A. A grantor of a grantor trust does not report income from the trust unless distributions are made from the trust.
 - B. A grantor trust is a good way to shelter income.
 - C. Income from a grantor trust is taxed to the grantor in the same manner as if no trust existed.
 - D. All of the statements are true.

Turn to the next page for Part 3, Section C.

Part 3

Section C:

Questions 46 – 80

The following questions may require some computation. Select the most appropriate answer and darken completely the oval under the corresponding letter on the answer sheet.

46. ABC, Inc., a regular domestic corporation and calendar year taxpayer, had taxable income of \$10,000 for the year 2001. Because the company's accountant was on vacation during the month of March 2002, the corporate income tax return was not filed in a timely manner and no extension was filed. The new accountant mailed the return on June 15, 2002. Disregarding any possible late payment penalty, and assuming no estimated tax payments were made, calculate the maximum failure to file penalty that could be assessed against ABC, Inc.

- A. \$1,000
- B. \$350
- C. \$225
- D. \$270

47. Robert transferred an office building that has an adjusted basis of \$60,000 and a fair market value of \$105,000 to the Wargo Corporation in exchange for 100% of Wargo Corporation stock and \$10,000 cash. The building was subject to a mortgage of \$25,000, which Wargo Corporation assumed. The fair market value of the stock was \$75,000. Which is the amount of Robert's realized gain and recognized gain?

<u>Realized</u>	<u>Recognized</u>
A. \$55,000	\$30,000
B. \$50,000	\$30,000
C. \$50,000	\$10,000
D. \$35,000	\$10,000

48. Bob and Sam transfer a building with a basis of \$100,000 to the Redwood Corporation in exchange for 75% of each class of stock with a fair market value of \$300,000. The other 25% of the stock was already issued to Betty. What is the gain, if any, that Bob, Sam, or the Redwood Corporation must recognize?

- A. Bob and Sam, none; Redwood Corporation none.
- B. Bob and Sam, none; Redwood Corporation \$300,000.
- C. Bob and Sam, \$200,000; Redwood Corporation none.
- D. Bob and Sam, none; Redwood Corporation \$200,000.

49. Karen transferred property with an adjusted basis of \$45,000 and fair market value of \$50,000 to Holiday Corporation in exchange for 65% of Holiday Corporation's only class of stock. At the time of the transfer, the stock Karen received has a fair market value of \$55,000. What is Holiday Corporation's basis in the property after the exchange?

- A. \$ 0
- B. \$45,000
- C. \$55,000
- D. \$60,000

50. Robert sold his Lebec Corporation stock to his sister Karen for \$8,000. Robert's cost basis in the stock was \$15,000. Karen later sold this stock to Dana, an unrelated party, for \$15,500. What is Karen's **realized** gain?

- A. \$500
- B. \$7,000
- C. \$7,500
- D. \$0

51. Frank sold his Ranier Corporation stock to his sister Bernie for \$8,000. Frank's cost basis in the stock was \$15,000. Bernie later sold this stock to Wendy, an unrelated party, for \$15,500. What is Bernie's **recognized** gain or loss?

- A. \$500
- B. (\$7,000)
- C. (\$7,500)
- D. \$0

52. During 2001 the NOGO Corporation had the following items of income and expenses:

• Income from operations	\$50,000
• Dividend income from Cooper Corporation (a 10% owned corporation)	\$90,000
• Expenses of operations	\$40,000

What is the NOGO Corporation's dividends-received deduction, if any?

- A. \$74,000
- B. \$63,000
- C. \$82,000
- D. \$90,000

53. The Smith Corporation realized a long-term capital gain of \$10,000, a short-term capital gain of \$15,000 and a long-term capital loss of \$27,000. What is the amount and character, if any, of carry back or carry forward that the Smith Corporation could deduct?

- A. \$10,000 long-term gain.
- B. \$15,000 short-term loss.
- C. \$2,000 short-term loss.
- D. \$25,000 long-term loss.

54. Bob transfers property worth \$50,000 to the Acme Corporation and provides personal services worth \$5,000 in exchange for stock valued at \$55,000. Immediately after the exchange Bob owns 90% of Acme's outstanding stock. What is Bob's gain if any?
- A. No capital gain, no ordinary income.
 - B. No capital gain, \$5,000 ordinary income.
 - C. No capital gain, \$50,000 ordinary income.
 - D. \$5,000 capital gain, no ordinary income.
55. Bob and Frank buy an apartment building for \$100,000. Both Bob and Frank organize the Acme Property Corporation when the apartment building has a fair market value of \$500,000. They transfer the building to the corporation for all of its authorized capital stock, which has a par value of \$500,000. What is the gain, if any, that Bob, Frank, or the Acme Property Corporation must **recognize**?
- A. Bob \$250,000, Frank \$250,000, Acme Property Corporation \$500,000.
 - B. Bob none, Frank none, Acme Property Corporation none.
 - C. Bob none, Frank none, Acme Property Corporation \$500,000.
 - D. None of the above.
56. During the 2001 calendar year, the Baker Corporation distributed a dividend in the form of a building to its sole shareholder. The building has a fair market value of \$60,000 and an adjusted basis of \$20,000. The corporation has sufficient earnings and profits. Not considering any potential tax effect of any taxes on the distribution, the net effect of the transaction on earnings and profits is:
- A. An increase of \$ 40,000.
 - B. An increase of \$20,000.
 - C. A decrease of \$40,000.
 - D. A decrease of \$20,000.
57. The Charlie Corporation, a calendar-year, accrual-basis taxpayer, distributed shares of the David Corporation stock to Charlie's employees in lieu of salaries. The salary expense would have been deductible as compensation if paid in cash. On the date of the payment, Charlie's adjusted basis in David Corporation's stock was \$20,000 and the stock's fair market value was \$100,000. What is the tax effect to Charlie Corporation?
- A. \$100,000 deduction.
 - B. \$20,000 deduction.
 - C. \$20,000 deduction and \$80,000 recognized gain.
 - D. \$100,000 deduction and \$80,000 recognized gain.
58. The Richards Corporation distributed an airplane to its only shareholder, Bob. The airplane had a FMV of \$75,000 and an adjusted basis to the Richards Corporation of \$50,000. The airplane was subject to a secured loan of \$90,000, which Bob assumed. What is the Richards Corporation's gain or loss on the distribution?
- A. \$0
 - B. \$40,000
 - C. (\$15,000)
 - D. \$25,000
59. The Clutch Corporation decided to distribute shares of its own stock to its employees at year-end as a reward for a profitable year. Each employee was to receive 10 shares with a fair market value of \$150 per share. Employees were offered a choice of cash or a stock dividend. What is the effect on the employees from this distribution?
- A. Distributions of stock dividends and stock rights are tax-free to shareholders.
 - B. \$1,500 taxable income to the employees who chose to receive cash and no effect on the employees who received stock.
 - C. \$1,500 taxable income to each employee.
 - D. \$750 tax-free, \$750 taxable income.
60. As of December 31, 2001, John is a 50% shareholder of XYZ, Inc., an S Corporation, as well as a 75% shareholder of ABC, Inc., also an S Corporation. Both companies are calendar year taxpayers. Because of profitable years, each company elected to use the maximum depreciation deduction allowable under IRS Code Section 179 for the year. Assuming that each election was valid, what is the maximum amount of Section 179 deductions which can be passed through to John?
- A. \$40,000
 - B. \$30,000
 - C. \$24,000
 - D. None. Depreciation is not a pass through item.

61. Mary is the sole shareholder of A Company, Inc. (an S Corporation), as well as a 50% shareholder in B Company, Inc., also an S Corporation. During the 2001 tax year, both companies acquired qualified assets in order to take the IRS Code Section 179 election for the full allowable amount. Prior to the 2002 tax year, the companies had accumulated Section 179 deductions in the following amounts:

- Company A - \$180,000
- Company B - \$150,000

Calculate the maximum amount of Section 179 deduction Mary will be able to **recognize** on her personal income tax returns for the 2001 tax year.

- A. \$32,000
- B. \$48,000
- C. \$24,000
- D. Nothing, because accumulated Section 179 deductions previously taken exceed the combined cumulative amount allowable of \$200,000.

62. Bob and Sally, unmarried taxpayers, were equal sole shareholders of Lostalot, Inc., an S Corporation. The corporation realized a \$50,000 operating loss for the tax year ending December 31, 2001. As of December 31, 2000, Bob's basis in his stock was \$15,000 and Sally's was \$5,000. During the 2001 tax year, Sally mortgaged her home for \$25,000 and lent the money to the corporation. Although not personally liable, Bob told her not to worry and that if anything happened, he would help pay the mortgage debt. Calculate the amount of allowable loss deduction each shareholder would be able to **recognize** on their individual 2001 tax returns.

- A. Bob \$25,000 and Sally \$25,000.
- B. Bob \$15,000 and Sally \$5,000.
- C. Bob \$15,000 and Sally \$30,000.
- D. Bob \$15,000 and Sally \$25,000.

63. On January 1, 2001, Acme, Inc., a calendar year S Corporation, was owned by four individuals as follows: John: 50%, Bob: 25%, Dave: 20%, and Tom: 5%. On March 31, 2001, John sold his shares to Bob. On the same day Dave sold his shares to Tom. For the tax year ending December 31, 2001, the company realized an operating loss of \$100,000. Assuming that all four had sufficient basis in their stock, calculate each shareholder's recognizable loss for the 2001 tax year. To assist in the calculation, assume a 360-day calendar year, with 30 days in each month.

- A. John: \$50,000, Bob: \$25,000, Dave: \$20,000, and Tom: \$5,000.
- B. John: \$0, Bob: \$75,000, Dave: \$0, and Tom: \$25,000.
- C. John: \$12,500, Bob: \$62,500, Dave: \$5,000, and Tom: \$20,000.
- D. John: \$12,500, Bob: \$56,200, Dave: \$5,000, and Tom: \$18,750.

64. Gary died on March 18, 2001. The estate tax year ends on December 31, 2001. The estate had the following items of income during the year:

Interest	\$250
Dividends	\$150
Stock sale-stock proceeds net of broker's commission	\$10,000
Basis of the stock	\$9,900

The estate made no distributions during 2001. Which of the following statements regarding the requirement to file a Form 1041 tax return are true?

- A. The estate is **not** required to file a tax return.
- B. The estate is required to file a tax return.
- C. If the estate has expenses that reduce its income below \$600, no estate tax return is required.
- D. Both B and C.

65. From the information below, determine the taxable income on Janice's Form 1041.

<u>Income</u>		<u>Expenses</u>	
Taxable interest	\$4,000	Attorney's fees	\$1,500
Tax Exempt interest	\$2,000	Funeral expenses	\$5,000
Dividends	\$3,000	Executor's fees	\$ 500
Gain on sale of stock	\$1,000		

- A. \$8,000
- B. \$5,800
- C. \$6,400
- D. \$2,000

66. From the information below, determine the taxable income on Form 1041 for Hal's estate for the 2001 calendar year.

<u>Income</u>		<u>Expenses</u>	
Taxable interest	\$2,000	Attorney's fees	\$5,000
Dividends	\$3,000	Property taxes	\$1,500
401(k) distribution	\$50,000		

The property taxes had accrued prior to Hal's death. They were deducted on the estate's Form 706. The estate distributed \$10,000 of taxable income to beneficiaries.

- A. \$38,500
- B. \$38,500
- C. \$39,600
- D. \$48,500

67. John, who was not married, died on October 12, 2001. He did not leave any of his assets to charity. Given the following information, may the executor of the estate make the alternate valuation election, and if so, what is the value of the gross estate on the alternate valuation date?

	<u>FMV</u> <u>Date of Death</u>	<u>FMV</u> <u>Alternate Valuation</u>
Residence	\$1,000,000	\$1,010,000
Installment note	\$5,000	\$500
Stock	\$600,000	\$350,000
Expenses	(\$450,000)	(\$300,000)

- A. No, the election cannot be made.
- B. Yes, the election can be made. The alternate value of the gross estate is \$1,350,500.
- C. Yes, the election can be made. The alternate value of the gross estate is \$1,360,500.
- D. Yes, the election can be made. The alternate value of the gross estate is \$1,365,000.

68. Joseph died on November 2, 2001. Joseph left all of his assets, including an IRA, to his two sons equally. From the information below, determine if Joseph's sons qualify to claim an estate tax deduction on their returns when they report the taxable IRA distributions.

Assets and deductions

• House (no mortgage)	\$600,000
• Stocks	\$30,000
• IRA-distributed	\$400,000
• Administrative expenses	\$60,000

- A. No, because the amount of the taxable estate is less than \$1,000,000.
- B. Yes, because the amount of the income in respect of a decedent (the IRA) exceeds the estate's deductions.
- C. Yes, because the gross estate exceeds \$1,000,000.
- D. No, because the amount of the income in respect of a decedent (the IRA) is less than \$1,000,000.

69. Anissa is the sole beneficiary of her father's estate. The estate was closed ten months after her father's death, and the executor is filing one (first and final) Form 1041. After all expenses of the estate were paid, the following amounts were paid out to Anissa.

• Cash	\$12,000
• IRA (decedent had no basis)	\$300,000
• Wages paid after death	\$6,000
• Stock	\$75,000
• Life insurance	\$150,000

How much, if any, of the payment will be reported on Anissa's Form 1040 Federal income tax return?

- A. \$0
- B. \$6,000
- C. \$306,000
- D. \$543,000

70. Alberta, who had not given taxable gifts in any prior year, gave her five children the following gifts in 2001.

A car to Richard	\$14,000
Cash to Elizabeth	\$12,000
Stock to John	\$10,500
Stock to Jane	\$9,500
Cash to Robert	\$5,000

From the information above, determine the amount, if any, of taxable gifts given by Alberta.

- A. \$0
- B. \$1,000
- C. \$6,500
- D. \$41,000

71. Cassy, a single individual, has not been required to file a gift tax return in any prior year. In 2001, Cassy paid \$12,000 tuition directly to State University for her sister, Andrea. She gave her brother \$8,000 to pay medical bills for his daughter. She also donated \$20,000 to the United Way. Must Cassy file a gift tax return?

- A. No.
- B. Yes, because the gift to her sister exceeded \$10,000.
- C. Yes, because the United Way donation exceeded \$10,000.
- D. Yes, because the total gifts she gave during the year exceeded \$10,000.

72. John, who is not married, made the following transfers during 2001:

- \$10,000 to his son Bradley
- \$12,000 to his daughter Alexandria
- \$7,000 political contribution
- \$5,000 charitable contribution
- Car to his son Bradley (\$22,000 basis; \$15,000 FMV)
- Autographed baseball to his grandson Tommy (\$75 basis; \$500 FMV)

What is the gross amount of gifts that John will report on his 2001 Form 709 (before deductions) ?

- A. \$14,000
- B. \$32,000
- C. \$42,500
- D. \$49,500

73. Lace gave the following gifts during the year:

- Cash to her sister \$8,000
- Stocks to her brother \$12,000
- Cash to United Way \$15,000
- A car to her cousin \$16,000

Based on this information, what is the amount of taxable gifts given?

- A. \$0
- B. \$4,000
- C. \$8,000
- D. \$11,000

74. Margaret's 2001 Form 709, page 1 has the following entries:

- Tax on current-year gifts \$400,000
- Maximum unified credit \$220,550
- Credit used in prior years \$ 20,550

Based on this information, what is the balance due on Margaret's Form 709 Gift Tax Return this year?

- A. \$0
- B. \$179,450
- C. \$200,000
- D. \$379,450

75. Paul is the sole beneficiary of a trust that his father set up before his father's death. Given the following information, how much trust income, if any, must Paul report on his tax return?

- Adjusted total income \$ 9,000
- Adjusted tax exempt interest \$ 1,000
- Distributable net Income \$10,000
- Required distributions \$ 5,000
- Discretionary distributions \$ 2,500

- A. \$5,000
- B. \$6,750
- C. \$9,000
- D. \$10,000

76. The Alan Trust must distribute all of its income annually. Shown below are the trust's income and expenses for the year (\$100 of the fiduciary fee is allocable to the nontaxable interest). Based on this information, how much taxable income will be passed through to the trust's beneficiaries?

- Taxable interest \$3,000
- Tax exempt interest \$1,000
- Fiduciary fee \$400

- A. \$2,600
- B. \$2,700
- C. \$3,000
- D. \$3,600

77. The MLN Trust had the following income and deductions.

- Taxable interest \$4,000
- Capital gain \$1,000
- Fiduciary fee \$500

Assuming that capital gains are allocable to corpus, determine the trust's distributable net income.

- A. \$3,500
- B. \$4,000
- C. \$4,500
- D. \$5,000

78. The MRY Trust has adjusted total income of \$10,000. This amount includes a \$1,000 capital loss. The trust had no tax exempt interest income for the year. From the information below, determine the trust's distributable net income.

- A. \$9,000
- B. \$10,000
- C. \$11,000
- D. None of the above.

79. The JLB trust is a simple trust. Alan is the sole beneficiary of the trust. Capital gains are allocable to corpus. Based on the following information, what is the trust's distribution deduction?

- Interest \$1,700
- Dividends \$300
- Capital gains \$2,000
- Fiduciary fee \$1,000

- A. \$1,000
- B. \$1,500
- C. \$2,000
- D. \$3,000

80. The LMH trust is a simple trust. Given the following information, determine the trusts's distribution deduction.

- Adjusted total income \$15,000
- Adjusted tax exempt interest
 (Not included in total income) \$2,000
- Capital gain allocable to corpus \$3,000

- A.** \$10,000
- B.** \$12,000
- C.** \$13,000
- D.** \$15,000

End of Part 3.