

2003

**SPECIAL ENROLLMENT
EXAMINATION**

Part 2

**SPECIAL ENROLLMENT
EXAMINATION BOOKLET**

**September 17, 2003
1:30 P.M. TO 4:30 P.M**

**Sole Proprietorships
And Partnerships**



IRS

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Special Enrollment Examination

Part 2

Sole Proprietorships And Partnerships

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, 2002. Unless otherwise stated, all questions relate to the calendar year 2002.

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.

Scratch paper will be provided, but you may make necessary computations in the questions books. Raise your hand to attract the monitor's attention when you need extra supplies or for permission to leave the room.

!! New procedures!!

All materials must be turned in to the monitor before leaving the room:

Answer sheet: 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, 2004.

Examination booklets, scratch paper: You must also turn in your examination booklet and scratch paper (used and unused). These materials will be mailed to you after the examination has been administered at all sites.

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 questions, 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 questions book and retain it for purposes of your future comparison.

Part 2
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. The Marmalade Partnership has two partners who share partnership income and loss equally. The partnership has a fiscal tax year ending on June 30. In 2002, the partnership changes to a required tax year because there is no majority interest and files its tax return on the calendar tax year basis. The partnership is required to file an application for a change in tax year and obtain IRS approval.
2. Able and Baker Partnership owns 51% of the outstanding stock of the Galaxy Corporation. Galaxy maintains its books on the cash basis. As a related party, Able and Baker cannot deduct business expenses and interest that it owes Galaxy until payment is made and is included in Galaxy's gross income.
3. Generally, a taxpayer must depreciate MACRS (Modified Accelerated Cost Recovery System) property that was acquired in a like-kind exchange of other MACRS property over the remaining period of the exchanged property, and continue to use the same depreciation method.
4. If a car dealership receives a trade discount, a reduction in the cost of cars purchased for resale, the dealership must reduce its cost basis in the cars by the amount of the discount. If the dealership receives a cash discount, a reduction in the invoice price for paying within a prescribed time, the dealership may either reduce its cost basis in the cars or may allocate the discount to a special discount income account and report the discounts as income for the taxable period.
5. A length of service award will **not** qualify as deductible by the employer if the employee receives the award for less than five years of service and received another award (excluding one of very small value) during the same year or in any of the prior four years.
6. A statutory employee's business expenses are deductible on Schedule C or Schedule C-EZ (Form 1040) and are **not** subject to the reduction of 2% of adjusted gross income (AGI).
7. Listed Property (such as passenger automobiles weighing 6,000 pounds or less) must be used in business at least 50% or more in order to claim the section 179 deduction and depreciation under (MACRS) Modified Accelerated Cost Recovery System).
8. The business use limits generally do not apply to any listed property leased or held for leasing by anyone regularly engaged in the business of leasing listed property.
9. Brandon leases property for use in his business. Generally, if Brandon makes permanent improvements to the leased property, he can take depreciation for the improvements only.
10. Cost depletion and percentage depletion are used to figure depletion on mineral property. Generally, only an independent producer or royalty owner may use percentage depletion for oil or gas wells.
11. If a business partnership breaks up, and one of the former partners is insolvent and cannot pay any of the partnership's debts, the solvent partners may have to pay more than their share of the partnership's debts. If the solvent partners pay any part of the insolvent partner's share of the debts, they can take a bad debt deduction.
12. A commercial dress designer's fashion show is generally **not** considered entertainment when its purpose is to introduce new designs to store buyers.
13. Generally, a cash basis taxpayer can deduct insurance payments paid in advance, even if, in effect, it creates an asset with a useful life extending substantially beyond the end of the current year.
14. Generally, if a business is not operated for the purpose of making a profit, then any loss resulting therefrom cannot be used to offset income from salaries and wages.
15. An election may be made to roll over a capital gain from the sale of publicly traded securities (securities traded on an established securities market) into a specialized small business company (SSBIC).
16. A partnership ends when at least 25% of the total interest in the partnership capital and profits is sold or exchanged within a 12 month period, including a sale or exchange to another partner.

17. Sue buys a brand new qualified electric vehicle that she uses strictly for personal purposes in the United States. She is eligible for an income tax credit for this purchase.
18. A self-employed consultant has a business history of net profits and net losses as follows:
- | | |
|------|---------|
| 1998 | (\$400) |
| 1999 | \$800 |
| 2000 | \$200 |
| 2001 | (\$500) |
- In 2002, he would like to pay self employment tax even though he incurred a loss of (\$2,200). He qualifies for the optional self-employment tax computation.
19. The Occupational Tax and Wagering Tax are both imposed on wagering activities.
20. An Employer Identification Number (EIN) is required any time a new business is started.

Turn to the next page for Part 2 , Section B.

Part 2
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. Abraham becomes an equal partner in the Kit, Kat and Kidd Partnership in 2002. In 2001, he filed his personal tax return on the calendar tax year basis. The partnership reports income and expenses on the fiscal tax year basis. How should Abraham report partnership income or loss distributed to him?
- A. Abraham may choose a fiscal year to report income and expenses.
 - B. Abraham must report income and expenses on the calendar year basis.
 - C. Abraham may choose either a calendar tax year or fiscal tax year to report income and expenses.
 - D. Abraham may choose a fiscal tax year and later obtain IRS approval if he wishes to change to a calendar tax year for reporting income and expenses.
22. The Kilometer Partnership sells computers and maintains its accounting system on the accrual basis. Kilometer sold and delivered a computer on December 29, 2001 and billed the customer \$3,250 on January 7, 2002. Kilometer received the \$3,250 payment on February 15, 2002. The check cleared on February 22, 2002. On which date will Kilometer recognize this income?
- A. January 7, 2002.
 - B. February 15, 2002.
 - C. December 29, 2001.
 - D. February 22, 2002.
23. Generally, all of the following entities may use the cash method of accounting, **except**:
- A. A family farming corporation with gross receipts of \$25 million or less.
 - B. An entity with no inventories and average annual gross receipts of \$5 million or less.
 - C. A qualified personal service corporation.
 - D. A corporation that has long term contracts.
24. The Andee Partnership traded its panel truck with an adjusted basis of \$10,000 for a pick-up truck with a fair market value of \$15,000. Andee also received \$3,500 cash on the trade. What is the gain, if any, on this trade?
- A. -0-
 - B. \$3,500.
 - C. \$5,000.
 - D. \$1,500.
25. The Sprinkly and Meato Partnership bought investment property on March 9, 2001 and sold it on March 9, 2002. The property cost \$100,000 and it was sold for \$135,000. What is the character of the gain or loss?
- A. Long term gain of \$35,000.
 - B. Ordinary income \$135,000.
 - C. Short term gain of \$35,000.
 - D. Long term gain of \$135,000.
26. The following methods of accounting for inventory are considered acceptable, **except**:
- A. Cost.
 - B. First In First Out.
 - C. Last In First Out.
 - D. Trade Discount Method.
27. An election to amortize may be made for qualifying costs of **organization** for a partnership. Which of the following is **not** considered a qualifying cost?
- A. A cost incurred in the creation of the partnership and **not** for starting or operating the partnership trade or business.
 - B. Accounting fees for services incident to the organization or the partnership.
 - C. Legal fees for preparation of the partnership agreement.
 - D. The costs of acquiring assets for the partnership.

28. A businessman can deduct up to \$2,000 per year of expenses for attending conventions, seminars, or similar meetings held on cruise ships. All of the following requirements must be met, **except**:
- The convention, seminar, or meeting is directly related to your trade or business.
 - The cruise ship company provides a statement that it has adequate facilities to accommodate the needs of the convention, seminar, or meetings.
 - You attach a statement signed by you that includes information about (1) the total days of the trip; (2) the number of hours each day that you devoted to scheduled business activities; (3) A program of the scheduled business activities.
 - You attach to your return a written statement signed by an officer of the sponsoring organization or group that includes (1) A schedule of the business activities of each day of the meetings and (2) The number of hours you attended the scheduled business activities.
29. Which of the following penalties paid by Castle Construction Partnership is deductible?
- A penalty for late performance of a contract.
 - A penalty for late filing of Form 1065 Partnership return.
 - A penalty for violating the state maximum highway weight law.
 - A penalty paid to the city for violating the city's housing codes.
30. Which of the following losses generally **would not** generate a net operating loss:
- Loss from trade or business.
 - Casualty or theft loss.
 - Loss from rental property.
 - Loss created by sale of personal residence for less than its cost.
31. The receipt of Agricultural Program Payments by a farmer for refraining from growing crops should be reported as:
- Miscellaneous income on Form 1040.
 - Farm income, not subject to self-employment tax.
 - Rental income, not subject to self-employment tax.
 - Farm income, subject to self-employment tax.
32. In November of 2001, Farmer Smith, a cash basis taxpayer, sells 100 additional beef feeder cattle (raised for resale) due to severe lack of water in his area. Normally, these feeders sell in February 2002. The transaction is correctly reported:
- In 2001 as a capital gain or loss.
 - In 2002 as a capital gain or loss.
 - Upon election, as ordinary farm income in either 2001 or 2002.
 - Not taxable due to drought conditions.
33. Dan, a calendar year taxpayer, has the following amounts of gross income for 2002:
- Wages - \$10,000
Interest - \$2,000
Farm income - \$200,000
- Dan has tax, including self employment tax, of \$20,000, and withholding of \$1,000. To avoid any filing or estimated tax penalties, Dan must:
- File an estimated tax payment by January 15, 2003, and pay 60% of the tax due.
 - File his tax return and pay all tax due by March 1, 2003.
 - File an estimated tax payment by March 1, 2003, and pay 66 2/3% of the tax due.
 - File his tax return and pay all tax due by April 15, 2003.
34. Farm income averaging is computed on Schedule J, which may be filed:
- For the current year when a taxpayer files Schedule F showing a farm loss.
 - For the current year which includes Schedule F showing net income from farming.
 - Only by IRS after the taxpayer's return is completed and reviewed.
 - On a family farming corporation with less than \$25 million in gross receipts.
35. Which of the following partnership items must be separately stated on the **partner's** K-1:
- Cost of goods sold.
 - Employee benefit programs.
 - Charitable contributions.
 - Taxes and licenses.

36. A partner is considered **not at risk** for which of the following amounts:
- The money and adjusted basis of any property the partner contributed to the activity.
 - The partner's share of net income retained by the partnership.
 - An allocation of a loss, deduction, or expense attributable to a partnership non-recourse liability.
 - Certain amounts borrowed by the partnership for use in the activity if the partner is personally liable for repayment.
37. Jane gave each of her two children, Jake & Jeff, a 30% interest in her clothing store. Capital is a material income-producing factor. Jeff is 21 and has worked in the store since he was 15 and has developed significant sales skills and helps his mom with the management duties. Jake is 25, married and has a job in another state and does not participate in any of the store's management decisions. Who are recognized as partners?
- Jane.
 - Jane and Jake.
 - Jane, Jake, and Jeff.
 - Jane and Jeff.
38. In which of the following ownership combinations would Fred be treated as owning more than 50% of the partnership?
- Fred 20%
Fred's Son 20%
Fred's Uncle 60%
 - Fred 25%
Fred's Wife 10%
Fred's Aunt 75%
 - Fred 40%
Fred's Nephew 20%
Fred's Son 40%
 - Fred 45%
Fred's Cousin 55%
39. A partner's basis in a partnership interest includes the partner's share of a partnership liability in all of the following, **except**:
- A liability that creates or increases the partnership's basis in any of its assets.
 - A partner's share of accrued but unpaid expenses of a cash basis partnership.
 - A liability that is a nondeductible, non-capital expense of the partnership.
 - A liability that gives rise to a current deduction to the partnership.
40. When payments are made to a retiring partner, or successor in interest of a deceased partner, for an interest in the partnership property, which of the following is correct?
- Payments that are based on partnership income are not taxable as a distributive share of partnership income but for the interest in the partnership.
 - A retiring partner is treated as a partner until his/her interest in the partnership has been completely liquidated.
 - Payments made for a retiring partner's share of the partnership's unrealized receivables are treated as made in exchange for partnership property if capital is not a material income-producing factor and the retiring partner was a general partner.
 - If the amount of the payment is based on partnership income, the payment is treated as a guaranteed payment.
41. The General Business Credit cannot lower your tax below:
- The poverty level for the year.
 - The taxpayer's tax for the prior year.
 - A number IRS announces each year.
 - The taxpayer's alternative minimum tax for the tax year.
42. The Investment Credit is:
- A credit for purchasing a business.
 - Based on 20% of investment interest.
 - A total of the Energy Credit, Reforestation Credit, and the Rehabilitation Credit.
 - Available only for businesses with loans from the Small Business Administration.
43. In 2002, Santergraph, Inc. remodeled and converted a portion of their building into a licensed child care facility open for the care of any of their employees' children. The cost of this remodeling qualifies for which of the following:
- An asset to be depreciated over the remaining useful life of the building.
 - An adjustment to income of 75% of the costs, with the balance depreciable.
 - A tax credit of 25% of the qualified expenses, maximum credit of \$150,000, with the balance depreciable.
 - Section 179 expensing election.

44. Maude has a small business that has a profit of \$15,000. Her husband, Harold, has a farm that has a loss of \$7,000. They are married. Which of the following is **correct** regarding their self-employment tax computation?
- A. If they file separately, Harold may **not** elect to use the optional method.
 - B. Maude must pay self-employment tax on \$15,000.
 - C. On a joint return, the self-employment tax may be computed based on \$8,000 of income for Maude only.
 - D. If they file separately, they may elect to split the net profit for self-employment tax purposes, each paying based on \$4,000.
45. In 2002, Animor, a self-employed business man, has prepared payroll tax returns and income tax returns for Yethir, Inc. on a continuous basis. In 2002, Yethir, Inc. paid Animor \$900 for his services. What is Yethir, Inc.'s reporting responsibility?
- A. File a W-2 for \$900.
 - B. File a 1099 MISC for \$900.
 - C. No documents need to be filed because the payee is a sole proprietor.
 - D. No documents need to be filed because the payer, Yethir, Inc., is incorporated.

Turn to the next page for Part 2, Section C.

Part 2
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. DUG Partnership operates a business. Its tax year ends on December 31, 2002. A partner dies on August 20th. The deceased partner's (and his or her estate's) distributive share of partnership income for the year of death is \$18,000. The partner's share of self-employment income from the partnership is:
- A. \$18,000.
 - B. \$ 11,500.
 - C. \$ 12,000.
 - D. \$ 9,000.
47. The Phineas and Lily Partnership bought a business for \$500,000 on Jan. 15, 2002. Included in the purchase price were business assets as follows: a certificate of deposit \$100,000, accounts receivable of \$50,000, a truck with fair market value of \$80,000, and a milling machine with a fair market value of \$20,000 and an adjusted basis of \$18,000. For depreciation purposes, what portion of the \$500,000 lump-sum payment is allocated to the milling machine?
- A. \$18,000.
 - B. \$53,320.
 - C. \$20,000.
 - D. \$50,000.
48. Dianne's Desserts, a sole proprietorship, bought a building for \$350,000 cash in January 2002. Settlement costs were \$12,500. The business placed \$15,000 in escrow for future payment on taxes and insurance and assumed an existing mortgage of \$20,000 on the property. Legal fees of \$7,500 were incurred for defending and perfecting title in a lawsuit that occurred during 2002. What is the adjusted basis of the building on December 31, 2002?
- A. \$390,000.
 - B. \$405,000.
 - C. \$385,000.
 - D. \$377,500.
49. The Needle and Thread Partnership traded an old machine having an adjusted basis of \$10,000 and cash of \$2,000 for a new machine with a fair market value of \$15,000. What is the recognized gain and what is the basis of the new machine?
- | <u>Gain</u> | <u>Basis</u> |
|-------------|--------------|
| A. \$-0- | \$12,000. |
| B. \$-0- | \$10,000. |
| C. \$2,000 | \$15,000. |
| D. \$3,000 | \$12,000 . |
50. The Post and Rail Partnership traded a piece of farm land with an adjusted basis of \$4,000 for a farm tractor that has a fair market value of \$9,000 and an adjusted basis of \$8,000. What is the recognized gain or loss?
- A. \$5,000.
 - B. \$4,000.
 - C. \$1,000.
 - D. None, it is a like kind exchange.
51. Arthur is a proprietor of Arthur's Pizza Emporium. He bought a commercial building several years ago. He made a down payment of \$20,000 in cash and assumed a mortgage for \$100,000. After he paid off the mortgage, Arthur later sold the building for \$180,000. Straight line depreciation taken up to the date of sale was \$18,000. What is the total gain on the sale?
- A. \$78,000.
 - B. \$80,000.
 - C. \$60,000.
 - D. \$160,000.
52. Luck and Charm Partnership provides consulting services to the public. In 2002, the firm performed services and in exchange received a truck with a fair market value of \$10,000, adjusted basis of \$7,500; and also received lawn care services with a fair market value of \$5,000. Luck and Charm uses the cash basis method for accounting purposes. What must Luck and Charm report as income for 2002?
- A. \$12,500.
 - B. \$10,000.
 - C. \$5,000.
 - D. \$15,000.

53. The taxpayer earned \$1,000 in interest in 2000. Taxpayer withdrew \$700 in 2001 and \$300 in 2002. How much of the original \$1,000 should taxpayer report as interest earned in 2002?
- 0-
 - \$300.
 - \$700.
 - \$1,000.
54. The adjusted basis of Rebecca's partnership interest is \$17,500. She received a distribution of \$9,000 cash and a piece of land with an adjusted basis of \$2,500 and a fair market value of \$4,000. What is the gain to be recognized at the time of these distributions?
- \$1500.
 - \$-0-.
 - \$4500.
 - \$6000.
55. Peter is a partner in the Waltz, Foxtrot and Tango Partnership. The adjusted basis of his partnership interest at the end of the year 2001 was \$30,000, which includes his \$12,000 share of partnership liabilities. Peter sold his interest in the partnership for \$20,000, and was relieved of his share of partnership liabilities. What is the gain or (loss) Peter must recognize?
- \$-0-.
 - \$32,000.
 - (\$10,000).
 - \$2,000.
56. Joan's adjusted basis in the So-Lo Partnership is \$15,000. She received a non-liquidating cash distribution of \$2,500 and a piece of land with an adjusted basis of \$7,500 and a fair market value of \$5,000. What is the gain or loss to be recognized at the time of the distribution?
- \$5,000 loss.
 - \$2,500 loss.
 - \$-0-.
 - \$5,000 gain.
57. Jeremiah, a cash basis taxpayer, is a salesman. He sold \$100,000 of merchandise in March 2001. His commission is 2% of sales. In November 2001, he received \$2,000 in commissions for those sales and an advance of \$7,000 in commissions for future sales in 2002. What amount must John include in his income for 2001?
- \$9,000.
 - \$2,000.
 - \$3,167.
 - \$-0-.
58. Derek Dunn received three employee achievement awards during the year: a nonqualified plan award of a watch which cost \$250 and two qualified plan awards of a computer which cost \$1500 and a radio which cost \$400. The requirements for qualified plan awards are satisfied. What amount, if any, must Derek include in Income?
- \$-0-.
 - \$1,150.
 - \$550.
 - \$1,500.
59. Alan is a sole proprietor of the SAFE Auto Towing Company. Alan paid Landslide Land, Inc., (unrelated), \$24,000 for the entire year 2002 for the use of the garage where he operates his business. On September 1, 2002, Alan signed a contract to purchase the garage. His rent payments from September through December will be applied to his equity interest in the business. What is the rent expense deduction that Alan may take on his Schedule C for 2002?
- \$24,000.
 - \$ - 0 -.
 - \$8,000.
 - \$16,000.
60. On January 1, 2002, Carrie leased property for her business for 5 years for \$6,200 per year. Carrie paid the full \$31,000 during the first year of the lease. What is Carrie's rental deduction for the year 2002?
- \$31,000.
 - \$6,200.
 - \$15,500.
 - \$24,800.

61. Pat Snow bought a truck weighing 8,000 lb. She uses the truck to make deliveries in her candy business. She bought the truck on July 1, 2001 at a cost of \$25,000. What is the first year's depreciation under the MACRS rules using the following table?

Table A-1

Year	3yr	5yr	7 yr	10 yr
1	33.33%	20.00%	14.29%	10.00%
2	44.45%	32.00%	24.49%	18.00%

- A. \$3,060.
 B. \$5,000.
 C. \$3,572.50.
 D. \$2,500.00.
62. Jeanne incurred start-up costs for her new business, which opened October 1, 2002. The costs were for advertising of \$1,000, a market analysis survey of \$2,500, employee training costs of \$6,000, and travel costs for securing prospective distributions of \$2,500. What part of the amortizable costs may be deducted in 2002?
- A. \$12,000.
 B. \$2,400.
 C. \$600.
 D. \$200.
63. The Flap Jack Partnership, guaranteed a \$30,000 note for Elegant Restaurant, one of Flap Jack's customers, for a good faith business purpose. Elegant Restaurant filed for bankruptcy and defaulted on the loan after paying \$10,000 of the note. Flap Jack Partnership paid the bank the balance of the note. What is the amount Flap Jack Partnership can deduct as a bad debt?
- A. \$-0-
 B. \$10,000.
 C. \$20,000.
 D. \$30,000.
64. Horse and Carriage Partnership distributed the following gifts to their clients: 100 clipboards with their company logo on them, valued at \$3 each (\$300); 50 bottles of wine to clients who had orders over \$50,000 in 2002 costing \$35 each (\$1,750) at Christmas. The amount that Horse and Carriage Partnership can deduct for business gifts in 2002 is:
- A. \$300.
 B. \$1,550.
 C. \$1,750.
 D. \$2,050.
65. Ellie operates a restaurant business and Joyce works as a waitress only Monday through Friday from 7 a.m. to 4 p.m. Ellie provides Joyce with a free breakfast and lunch each day, including Saturday and Sunday. Ellie values the breakfast at \$5 a day and lunch at \$7 a day. How much should Ellie add to Joyce's weekly paycheck for meals that she ate?
- A. \$0.
 B. \$24.
 C. \$60.
 D. \$84.
66. Dawn meets the requirements for deducting expenses for the business use of her home. She uses 20% of her home for her business. She had the following income and expenses. What amount of depreciation will be allowed under the office in home deduction limitation rules?
- Gross income from business \$6,000
 - 20 % of the Home mortgage and interest expense \$3,000
 - 100% of business supplies & business phone \$2,000
 - 20% of home maintenance, insurance, & utilities \$800
 - Depreciation (calculated on 20% of cost of the home) \$1,600
- A. \$ 0.
 B. \$ 200.
 C. \$ 800.
 D. \$1,600.

67. You buy an interest in a partnership for \$20,000 using borrowed funds. The partnership's only assets include machinery used in the business valued at \$60,000 and stocks valued at \$15,000. In 2002 you paid \$2,000 interest on the loan. How much interest is deductible as interest attributed to a trade or business?
- \$ 0.
 - \$ 400.
 - \$1,600.
 - \$ 2,000.
68. Rudy, a plumber, paid the following taxes: \$800 on the purchase of a new truck, \$1,500 for the current year's property tax, \$150 sales tax on miscellaneous office supplies, \$600 sales tax on merchandise he purchased for resale. How much can he deduct as a current business expense for tax purposes?
- \$150.
 - \$1,650.
 - \$2,250.
 - \$3,050.
69. Clarence sold his business backhoe for \$65,000. He purchased the backhoe in 1999 for \$90,000. He has taken \$60,000 of depreciation, which includes \$10,000 Section 179 expensing election. Clarence will report the following on the sale of the backhoe:
- Ordinary loss of \$25,000.
 - Long-term capital gain of \$35,000.
 - Ordinary income of \$35,000.
 - Ordinary income of \$10,000 and long-term capital gain of \$25,000.
70. In 2002, Jason sold a business lot to his son Adam for \$120,000. Jason received this lot in a tax-deferred exchange in 2000 for a lot that cost him \$175,000 in 1997. Jason will recognize the following on his 2002 tax return:
- No gain or loss.
 - An ordinary loss of \$55,000.
 - A long term gain of \$120,000.
 - A long term loss of \$175,000.
71. Sally's business office was condemned to make way for an expanded highway on May 1, 2002. Sally's adjusted basis in her building was \$20,000 (\$80,000 original cost less \$60,000 in depreciation). Her proceeds from condemnation were \$220,000. Sally replaces her office on November 10, 2002 at a cost of \$185,000. Sally must recognize a gain of:
- \$200,000.
 - \$0.
 - \$35,000.
 - \$60,000.
72. A farmer has the following sources of income:
- | | |
|-----------------------------------|-----------|
| • Milk sales | \$100,000 |
| • Sales of old dairy cows | \$12,000 |
| • Agricultural Program Payments | \$30,000 |
| • Sales of calves raised for sale | \$2,000 |
| • Corn sales | \$24,000 |
| • Tractor sold | \$7,000 |
- The income to be reported on Schedule F, "Profit or Loss from Farming", is:
- \$175,000.
 - \$156,000.
 - \$168,000.
 - \$163,000.
73. Simon and Maggie Partnership, a calendar year partnership, with two partners, filed its 2001 Form 1065 tax return on December 31, 2002. An extension of time to file was not filed. What is the amount of their Failure to File penalty?
- \$ 50.
 - \$100.
 - \$500.
 - \$900.
74. Jasmine is a calendar year taxpayer, is a partner in Jasmine and Prince Partnership that has a fiscal year ending March 31. Starting April 1, 2002 Jasmine receives a fixed monthly guaranteed payment of \$1,000 a month without regard to the income of the partnership. How much of the guaranteed payment will Jasmine report on her 2002 tax return?
- \$ 0.
 - \$8,000.
 - \$9,000.
 - \$12,000.

75. Mike invested \$10,000 cash for a 25% interest in Matthew and Lewis partnership. Mike materially participates in the partnership business. Matthew and Lewis Partnership had an \$80,000 loss in 2002. The partnership agreement states that Mike is additionally liable for all of the partnership liabilities of \$5,000. What is the amount of Mike's deductible loss for Matthew and Lewis Partnership?
- \$10,000.
 - \$11,250.
 - \$15,000.
 - \$20,000.
76. Zeke is a partner in Butter and Egg Partnership. Zeke is to receive 40% of the partnership's income, but not less than \$20,000. The partnership has a net income of \$10,000 after deducting the \$20,000 in 2002. How much can the partnership deduct for Zeke's guaranteed payment on Form 1065 Partnership Return.
- \$0.
 - \$8,000.
 - \$12,000.
 - \$20,000.
77. Marlene acquired a 30% interest in a partnership by contributing property that had an adjusted basis to her of \$25,000, fair market value of \$50,000 and a \$40,000 mortgage. The partnership assumed the liability. What is Marlene's gain or loss on the contribution of her property to the partnership?
- \$0.
 - \$3,000 gain.
 - \$12,000 gain.
 - \$10,000 loss.
78. On January 1, 2001, Brian contributed \$20,000 cash to Lock and Key Partnership for a 25% interest. The adjusted basis of his partnership interest at the end of 2002 was \$35,000, which included his \$16,000 share of partnership liabilities and the contributed cash. The partnership had no other liabilities and no unrealized receivables or substantially appreciated inventory items. On December 31, 2002 Brian sold his entire interest in Lock and Key Partnership for \$19,000 cash. Brian did not take any distributions in 2002. What is the amount of Brian's capital gain or (loss)?
- \$0.
 - (\$1,000).
 - \$16,000.
 - \$19,000.
79. Clyde is a limited partner in Marathon Marchers Partnership. He contributed \$40,000 in cash on the formation of the partnership. His current adjusted basis in the partnership is \$50,000, which includes his share of partnership liabilities of \$10,000. Clyde's share of unrealized receivables in the partnership is \$12,000. Clyde sold his partnership interest for \$85,000 cash. What is the amount and character of Clyde's gain?
- | | <u>Capital Gain</u> | <u>Ordinary Gain</u> |
|----|---------------------|----------------------|
| A. | \$ 0 | \$35,000. |
| B. | \$45,000 | \$ 0. |
| C. | \$33,000 | \$12,000. |
| D. | \$23,000 | \$12,000. |
80. In 2002, Colleen started a SIMPLE plan for all five of her employees and herself. It cost her \$400 in fees to administer the plan. She never had a pension plan prior to starting this plan. Her tax credit is:
- \$200.
 - \$400.
 - \$0.
 - \$100.

End of Part 2.

