2005

SPECIAL ENROLLMENT
EXAMINATION

IRS

Department of the Treasury
Internal Revenue Service

publish.no.irs.gov

Publication 869 (Rev. 9.-2005)
Part 2
Catalog Number 32646M

Part 2

SPECIAL ENROLLMENT EXAMINATION BOOKLET

September 21, 2005
1:30 P.M. TO 4:30 P.M

Sole Proprietorships And Partnerships

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(Declassified After September 21, 2005)

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Special Enrollment Examination

Part 2

Sole Proprietorships And Partnerships

Instructions:

Time allotted. You will have 3 hours to take the exam. No additional time will be given.

Source of questions. All references are to the Internal Revenue Code as amended through December 31, 2004. Unless otherwise stated, all questions relate to calendar year 2004.

Supplies provided. You will be given a No. 2 pencil, scratch paper, question booklet, and answer sheet. You may make computations on the scratch paper or question booklet and will turn these in with your test.

Contacting the monitor. Raise your hand to attract the monitor's attention if you need additional supplies or would like permission to leave the room.

Completing the answer sheet and making notes in the question booklet.

- Be sure to read each question carefully.
- Do not fold or tear the answer sheet since it will be machine graded.
- Use your No. 2 pencil to darken only one oval for each question.
- If you would like to make a correction, erase the error completely.
- You may want to also mark your answers in the question booklet because the booklet will be returned to you when your test has been graded. Your answer sheet will not be returned to you. The correct answers will be provided to you and you would then have the opportunity to compare your answers to the correct answers.

After you have finished.

- **Answer sheet.** You must turn in your answer sheet at the end of each test session or your test will not be graded. When you have finished the examination, you must turn in your answer sheet to the monitor before leaving the room.
- **Question booklet and scratch paper.** You must also turn in your question booklet and scratch paper (used and unused) before leaving the room. Any answers noted in your question booklet will not be graded. Your question booklet and scratch paper will be mailed to you after the examination has been administrated in all sites.

Grading.

- **Point value of questions.** 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.
- **Determination of correct answers.** The examination is graded on the basis of correct answers. If you darken more than one oval in answering a question, the answer will be considered incorrect.
- **Notification of results.** You will receive formal notification of your examination results on or about January 31, 2006.

Challenges. Challenges must be received by the Office of Professional Responsibility on or before October 22, 2005. Challenges must be on the form or in the format prescribed on www.irs.gov. Go to "tax professionals" and then to "enrolled agents".

Complete Personal Identifying Information: On you answer sheet in the space provided, you should enter the following information:

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 you 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.

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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. Daryl's gross receipts from the manufacture and sale of boots have exceeded $1,000,000 for 3 consecutive years. He is changing from the cash method of accounting to the accrual method of accounting. He reports the business activity as a sole proprietor on a Schedule C with his individual income tax return. He does not need the Commissioner's approval to change his method of accounting.

2. The Pine Tree Partnership produces and sells toys. It had gross receipts of $1,000,000 in 2004. It had gross receipts of $500,000 in 2001, $1,000,000 in 2002, and $1,500,000 in 2003. Pine Tree may use the cash method of accounting.

3. Alayna bought a parcel of improved property on October 15, 2003. On April 15, 2004, Alayna traded this property for a parcel of unimproved property. On October 14, 2004, Alayna sold the unimproved property. Alayna's holding period of the unimproved property includes the holding period of the improved property.

4. Ralph transfers property with a basis of $50,000 to a corporation, which is an investment company, in exchange for stock that has a fair market value of $100,000. After the exchange, Ralph owns 80% of the total combined voting power of the stock and 80% of the outstanding shares. Ralph is not required to recognize any gain on this transaction.

5. The cost of inventory must be reduced by any trade discounts received.

6. For an employee's pay to be considered deductible, it must be reasonable, ordinary and necessary, paid for services actually performed, and paid or incurred during the tax year.

7. Generally, a worker who performs services for you is your employee. This remains the case even if you do not have the right to control how the worker performs those services.

8. Direct sellers and qualified real estate agents are by law considered non-employees. They are treated as self-employed for all Federal tax purposes, including income and employment taxes.

9. There are two ways of figuring depletion: cost depletion and percentage depletion. For mineral property, you generally must use the method that gives you the largest deduction.

10. John has a Schedule C business and timely files his individual income tax return. However, he fails to pay his tax bill timely and is assessed interest on the past due taxes. Because the past due tax is related to his Schedule C business income, John can deduct the interest as a business deduction when paid.

11. The entire sales tax paid on depreciable business property is a currently deductible expense.

12. In 2004, Bob sold 100 shares of a large publicly traded company at fair market value to his sister Phyllis. Bob had purchased these shares in 1999 for $5,000. At the time of sale these shares were worth only $3,000. Bob cannot currently deduct any part of his $2,000 loss.

13. John maintains an inventory of ski equipment at his lodge in Winter Park Colorado. He is an accrual basis taxpayer and reports his business income on a Schedule C each year. In November of 2004 an avalanche destroyed 50% of the equipment. John will reflect his loss of inventory by properly reporting both his beginning and ending inventory in his cost of goods sold.

14. John is a partner in the Milo partnership. During 2004, John personally assumed $10,000 of the partnership's liabilities. The assumption of partnership debt by John is treated as a distribution of money to John by the partnership and decreases John's basis in the partnership.

15. An individual is considered as owning the partnership interest that is directly or indirectly owned by or for his or her family. Family includes only brothers, sisters, half-brothers, half-sisters, spouse, ancestors, and lineal descendants.

16. If a partner contributes property to a partnership, the partnership's basis for determining depreciation, depletion, and gain or loss on the disposition of the property is the same as the partner's adjusted basis for the property when it was contributed, increased by any gain recognized by the partner at the time of contribution.

17. In 2004, Charlie retired from the Atlas Partnership. He received $250,000 in exchange for his interest in partnership property. The $250,000 is considered a distributive share to Charlie, and Atlas can deduct the $250,000.

18. Karen has a Schedule C business requiring the use of a large warehouse for her inventory. To assist her employees in getting around the warehouse, she purchased five Segway Human Transporters in 2004. These two wheeled vehicles are powered by an electric motor drawing current from rechargeable batteries. All five vehicles qualify for the Electric Vehicle Credit.

19. For purposes of figuring and reporting self-employment tax, if you have more than one trade or business, you must combine the net profit or loss from each business.

20. You must have an Employer Identification Number if you do either of the following: (a) pay wages to one or more employees, or (b) file pension or excise tax returns.

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. A partnership, S corporation or personal service corporation can elect to use a tax year other than its required tax year, if it:
   A. Elects a year that meets the deferral period requirement
   B. Is not a member of a tiered structure as defined by the regulations
   C. Has not previously had an election in effect to use a tax year other than its required tax year
   D. All of the above

22. Eric, a cash basis taxpayer, owned 25% of Watson, Inc. stock. Watson, Inc. files a calendar year U.S. Corporate Income Tax Return Form 1120 employing the accrual method of accounting. Eric loaned Watson, Inc. $100,000 at the beginning of 2003. The accrued interest on this loan was $5,000 as of December 31, 2003. Watson, Inc. paid Eric the $5,000 in January of 2004. How should Eric report the interest income and Watson, Inc. report the interest expense from this transaction?
   A. Watson, Inc. reports the expense in 2003 and Eric reports the income in 2003
   B. Watson, Inc. reports the expense in 2003 and Eric reports the income in 2004
   C. Watson, Inc. reports the expense in 2004 and Eric reports the income in 2004
   D. None of the above

23. Which of the following transactions qualifies as a like-kind exchange?
   A. The exchange of a copyright on a novel for a copyright on a song
   B. An exchange of the "goodwill or going concern value" of a business for the "goodwill or going concern value" of another business
   C. An exchange of land improved with an apartment house for land improved with a store building
   D. An exchange of personal property used predominantly in the United States for personal property used predominantly outside the United States

24. Special rules apply to like kind exchanges between related persons. Under these rules, related persons are:
   A. The taxpayer and a member of his/her family
   B. The taxpayer and a corporation in which the taxpayer has a 25% ownership
   C. The taxpayer and a partnership in which the taxpayer directly or indirectly owns a 25% interest in the capital or profits
   D. All of the above

25. Which of the following does not qualify as a nontaxable exchange or transfer?
   A. A life insurance contract for an annuity contract
   B. A general partnership interest for a general partnership interest in the same partnership
   C. A transfer of property from an individual to a former spouse, incident to divorce
   D. None of the above

26. Mark is an accrual basis taxpayer. He shipped $500 worth of merchandise to Ralph on December 30, 2004. Mark sent Ralph an invoice January 2, 2005 that was payable in 30 days. Ralph mailed his check to Mark on February 2, 2005. Mark deposited the check on February 6, 2005. Mark received and reconciled his bank statement March 3, 2005. When does Mark record the $500 in income?
   A. January 2, 2005 because that is when he invoiced Ralph
   B. March 3, 2005 because that is when Mark verified that the $500 check had been accepted as a deposit
   C. December 30, 2004, the date when he shipped the merchandise to Ralph
   D. February 6, 2005 because that is when Mark deposited the check from Ralph

27. Which of the following items are generally included in inventory?
   A. Goods for sale that someone else has consigned to you
   B. Equipment used in your business to manufacture goods
   C. Goods you have sent out on consignment for someone else to sell
   D. Goods in transit to you for which title has not yet passed to you

28. Supplemental wages are compensation paid in addition to an employee's regular wages. They **do not** include payments for:
   A. Accumulated sick leave
   B. Nondeductible moving expenses
   C. Vacation pay
   D. Travel reimbursements paid at the Federal Government per diem rate

29. Which of the following fringe benefits for meals is subject to the 50% deduction limit?
   A. Meals furnished to your employees at the work site when you operate a restaurant
   B. Meals furnished to your employees as part of the expense of a company picnic
   C. Meals furnished to your employees at your place of business when more than half of these employees are provided the meals for your convenience
   D. Meals furnished to a customer during a business discussion

30. Esther works as a computer programmer for a marketing firm. She performs 40% of her computer programming on a home computer during the weekend (her company is closed on the weekends) so she can take off 2 days during the regular work week. The home computer that Esther works on is identical to the computer she uses at work, and she uses it exclusively for her job related duties. Esther's employer does not require Esther to take work home with her on the weekends—it is Esther's choice. Because she uses the home computer exclusively for business purposes, she can use the following percentage of business usage when computing her yearly depreciation for the computer:

A. 100%.
B. 40%.
C. 25%.
D. 0%.

31. Which of the following would not qualify for a depletion deduction?

A. Gas well
B. Timber lot
C. Oil refinery
D. Stone quarry

32. Walter is an accrual basis taxpayer who has a business with significant accounts receivables. In 2003, Walter had an $8,000 receivable owed to his business from Fred. Fred was unable to pay the full amount, but did transfer a parcel of land with a fair market value of $6,000 to Walter in partial payment. Walter entered on his books the $2,000 difference as a business bad debt, but was unable to take a tax benefit from this bad debt deduction as he had no taxable income at the end of 2003. In 2004, Walter sold the land received from Fred at a $3,000 gain. At the end of 2004, how much gain from the sale of this land must Walter report in taxable income?

A. $3,000 – the entire gain
B. $1,000 – the gain less the bad debt
C. $0 – any gain is limited to the amount of bad debt
D. None of the above

33. In 2004 you used a fishing lodge as an entertainment facility. Which of the following incurred expenditures may be partially deductible?

A. Depreciation expense
B. Fishing bait
C. Natural gas to heat the lodge
D. Repairs to the lodge roof

34. The standard meal allowance cannot be used to figure a deduction for:

A. Business travel if you are self-employed
B. Travel in connection with investment property
C. Travel for qualifying educational purposes
D. Travel to obtain medical treatment

35. Under which situation below is a deduction allowable for an office in your home?

A. Your home is the only fixed location of your business of selling mechanics' tools at retail. You regularly use your walk-in closet for storage of inventory and product samples. You also use this area occasionally for personal purposes
B. You are an attorney and use a den in your home to write legal briefs. Your family also uses the den for recreation
C. You use part of your home exclusively and regularly to read financial periodicals and reports, clip bond coupons, and carry out similar activities to monitor personal investments
D. You use your walk-in closet at home exclusively and regularly to bill customers, clients, or patients; to set up appointments; and to order supplies. You also rent office space downtown where you also conduct those same activities. You use the home office three days a week and the rented office space two days a week

36. Pleasant Beach City, to improve downtown commercial business, converted a downtown business area street into an enclosed pedestrian mall. The city assessed the full cost of construction, financed with 10-year bonds, against the affected business properties. The city is paying the principal and interest with the annual payments made by the property owners. The portion that the business owners were assessed to pay the construction costs is:

A. Deductible as taxes
B. Deductible as a business expense
C. A non-depreciable capital expenditure
D. A depreciable capital expenditure

37. On November 15, 2004, Partnership Z paid $10,000 in accounting and legal fees to prepare and file the partnership agreement. The partnership began business on December 1, 2004. Which of the following is a permissible election for treatment of the $10,000 payment?

A. Deduct $10,000
B. Deduct $5,000 and amortize the remaining $5,000 over a 5-year period
C. Deduct $5,000 and amortize the remaining $5,000 over 180 months
D. Amortize $10,000 over a 5-year period

38. Amounts paid or incurred to demolish a structure are:

A. Deductible as a casualty loss
B. Capitalized and amortized over a 180 month period
C. Treated as a reduction of the basis of the structure
D. Capitalized and added to the basis of the land where the demolished structure was located

39. Which of the following statements pertaining to a net operating loss (NOL) is incorrect?
   A. The carry back period for a farming loss is 5 years
   B. If you choose not to carry back an NOL then you can use the NOL only in the 20-year carry forward period
   C. To waive the carry back of an NOL, a separate statement must be submitted within 6 months of the original NOL year return's due date (including extensions)
   D. If you do not use an NOL within the 2-year carry back and 20-year carry forward period, you lose any remaining NOL forever

40. If at least two-thirds of your gross income for 2003 or 2004 was from farming, only one estimated tax payment is due. The required annual payment is the:
   A. Larger of two-thirds of your total tax for 2004 or 100% of the total tax shown on your full-year 2003 return
   B. Smaller of two-thirds of your total tax for 2003 or 100% of the total tax shown on your full-year 2004 return
   C. Larger of two-thirds of your total tax for 2003 or 100% of the total tax shown on your full-year 2004 return
   D. Smaller of two-thirds of your total tax for 2004 or 100% of the total tax shown on your full-year 2003 return

41. New ABC Partnership is organized in 2004 with three general partners. The partners include a corporation with a tax year ending on March 31 and a 60% interest in partnership capital and profits, and two individuals, each having a calendar tax year and a 20% interest in partnership capital and profits. The partnership's required tax year ends on:
   A. March 31
   B. September 30
   C. October 31
   D. December 31

42. The due date, without regard to extensions, of a domestic partnership filing U.S. Return of Partnership Income Form 1065 is the 15^{th} day of which month following the end of the tax year?
   A. Third
   B. Fourth
   C. Sixth
   D. Ninth

43. A newly-formed single-member domestic limited liability company (LLC) is eligible to file an election to be taxed as a:
   A. Disregarded entity
   B. Partnership
   C. Corporation
   D. Trust

44. Bill and Jimmy formed a new partnership. Bill contributes property that has an adjusted basis of $1,400 and a fair market value of $2,000 to the partnership. Jimmy contributes $2,000 in cash to the partnership. Each partner's capital account as reflected on the partnership's books is $2,000. What is the adjusted basis of each partner's interest?
   A. Bill's at $1,400 and Jimmy's at $1,400
   B. Bill's at $1,400 and Jimmy's at $2,000
   C. Bill's at $1,700 and Jimmy's at $1,700
   D. Bill's at $2,000 and Jimmy's at $2,000

45. Which of the following earnings is not subject to self-employment tax?
   A. Gains and losses, by a dealer in options or commodities, from dealing or trading in foreign currency contracts
   B. Fees earned by a professional fiduciary who administers a deceased person's estate
   C. Fees received for services performed as a notary public
   D. All of the above

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. Given the fact patterns below, which of the following entities may not use the cash method of accounting?

A. The Acme Partnership had gross receipts of $3,500,000 in 2004. Its gross receipts for 2003 were $8,000,000 and its gross receipts for 2002 were $3,000,000
B. John Jones manufactures and sells fans. His average annual gross receipts since 1999 are $975,000
C. Dallas Partnership has two partners in 2004—Joe Dallas, an individual, and Deer, Inc. a corporation. Dallas Partnership averaged annual gross receipts are $6,500,000
D. John Gibb files his 2004 Form 1040 with an attached Schedule C reflecting $11,000,000 in gross receipts from selling real estate

47. Setting Sun Partnership purchased a business, Family Dry Cleaners, for $750,000. The acquired Family Dry Cleaners assets consisted of the following:

- $50,000 in cash,
- Equipment with a fair market value of $200,000, and
- Land and building with a fair market value of $450,000.

For real estate tax purposes, the city assessed the value of the land at $100,000 and the building at $200,000. The buyer and seller did not enter into an allocation agreement for this transaction. What basis must Setting Sun Partnership use for the land, building, and intangible asset "goodwill"?

A. Land $100,000, Building $200,000, and Goodwill $150,000
B. Land $150,000, Building $300,000, and Goodwill $0
C. Land $150,000, Building $300,000, and Goodwill $50,000
D. Land $100,000, Building $350,000, and Goodwill $50,000

48. Mike purchased a building lot in 2001 for $25,000 and constructed his primary residence there for an additional $175,000. In 2004 Mike moved to a different city, but kept the house he constructed in 2001 and converted it to a rental property. On the date Mike made this change the fair market value of the converted property was $225,000. For depreciation purposes, what is Mike's basis in this rental property?

A. $150,000
B. $175,000
C. $200,000
D. $225,000

49. Nelson, Inc. owned a manufacturing building with a fair market value of $95,000 and an adjusted basis of $75,000. Nelson, Inc. entered into an agreement to exchange the manufacturing building for a warehouse with an adjusted basis of $80,000 and a fair market value of $90,000 with Roberts Corporation. In addition, Nelson, Inc. would pay Roberts Corporation $5,000 in cash. Nelson, Inc. also incurred and paid attorney and deed preparation fees of $5,000 on this exchange. What is Nelson, Inc.'s basis in the warehouse it received in this like-kind exchange?

A. $85,000
B. $90,000
C. $95,000
D. $100,000

50. Arlene traded her old computer that she used in her business, for a new computer priced at $5,000 that she will also use in her business. In addition to her old computer, Arlene paid $4,000 cash for the new computer. Her old computer was worth $2,000 and had an adjusted basis of $500. What is Arlene's basis for depreciation in the new computer?

A. $2,000
B. $3,000
C. $4,500
D. $1,000

51. Kayla exchanged her unimproved land with an adjusted basis of $80,000 and a fair market value of $130,000 for unimproved land with a fair market value of $100,000 and $10,000 in cash. Kayla also paid $5,000 in closing costs. The unimproved land that Kayla gave up was subject to a $30,000 mortgage for which she was liable. The other party assumed this mortgage. What is Kayla's realized gain on this exchange?

A. $40,000
B. $55,000
C. $35,000
D. $25,000

52. Under the "lower of cost or market" method, what is the value of the following items that should be included in closing inventory?

Item	**Cost**	**Market**
X	$450	$700
Y	$250	$100
Z	$300	$250
Total	$1,000	$1,050

A. $800
B. $1,000
C. $1,050
D. $1,250

53. Michael James purchased a travel agency on July 1, 2004, and immediately took over the business. The purchase contract included the following items as part of the purchase price:

- Goodwill valued at $60,000.
- Workforce in place valued at $30,000.
- Trademark valued at $60,000.
- Government Permit valued at $30,000.

What is the proper amount of Michael's Internal Revenue Code section 197 amortization expense for 2004 assuming Michael is a calendar year taxpayer?

A. $90,000
B. $30,000
C. $6,000
D. $12,000

54. In 2003, Rex, a sole proprietor of Bay View Wrecking, had gross income of $200,000, a business bad debt deduction of $6,000, and other expenses of $156,000. Bay View Wrecking employed the accrual method of accounting and used the specific charge-off method for bad debts. In 2004, Bay View Wrecking recovered $4,500 of the $6,000 previously deducted in 2003. What is the correct way for Rex to report this recovery?

A. Report $4,500 as "Other Income" on Schedule C in 2004
B. Report $4,500 as "Other Income" on return form 1040 line 21 in 2004
C. Report $4,500 as "Other Income" on an amended 2003 Form 1040X return
D. Report $4,500 as a reduction of "Bad Debt" on Schedule C in 2004

55. You sell products to the Sienna Company. To thank the company for its business, you gave the company three bottles of champagne. Each of the company's three executives took home a bottle for their families to share. You have no business relationship with any of the executives' family members. If you paid $40 for each bottle, the total amount can you deduct for all three bottles is:

A. $25
B. $60
C. $75
D. $120

56. Hahn Company, a calendar year taxpayer operating as a sole proprietorship, reports Federal income taxes employing the accrual method of accounting. Hahn Company shows the following items of income and expense for 2004:

Sales…………………………………………..$230,000
Cost of Sales………………………………….(70,000)
Operating Expenses
(excluding insurance)…………………….(40,000)
Insurance Expenses:
Self-employed
health insurance premium……………….(4,000)
Self-insurance reserve……………………(2,000)
Business liability insurance
premium for a 3-year policy
(from 7-1-04 to 6-30-07)……………...(15,000)

For 2004 year tax purposes, what is the amount of Hahn Company's net income reportable on Schedule C, "Profit or Loss from Business (Sole Proprietorship)"?

A. $117,500
B. $111,500
C. $111,000
D. $115,500

57. Between November 1 and December 1, 2004, you paid a total of $52,000 in start-up costs to create a new business. The business opened its doors on December 15, 2004. Which of the following is a permissible election for treatment of the $52,000 in start-up costs you paid?

A. Amortize $52,000 over a 5-year period
B. Deduct $3,000 and amortize the remaining $49,000 over 180 months
C. Deduct $5,000 and amortize the remaining $47,000 over 180 months
D. Amortize $52,000 over 180 months

58. Richard, a self-employed attorney, began a fishing guide business in 1998. He reports income and expense from this fishing guide activity on a Form 1040 Schedule C separate from his reported earnings as an attorney. The fishing guide business reported net losses each year while Richard's legal business showed significant net earnings in each of the years from 1998 to 2003. In 2004 Richard's business as an attorney showed a net profit of $50,000. Richard's fishing guide business had the following income and expenses in 2004:

- Gross income $5,500
- Depreciation of a boat and motor $(3,000)
- Real estate taxes $(500)
- Insurance $(250)
- Mortgage interest allocated $(1,500)
- Utilities allocated $(1,250)
- Supplies $(1,000)

Richard has itemized deductions that he will report on Schedule A of his 2004 Form 1040. How much depreciation deduction can Richard report from his fishing guide business activity in 2004?

A. $(3,000)
B. $(1,500)
C. $(1,000)
D. $(0)

59. In 2000, you purchased a candy making machine for your business. The machine cost $50,000 and you claimed a $20,000 Internal Revenue Code section 179 deduction for that machine. In 2004, you sold the machine for $52,000. Your accumulated depreciation from 2000 through 2004 was $18,974 (not including the section 179 deduction). How much is your taxable gain and what portion of that gain must be reported as ordinary income under Internal Revenue Code section 1245?

A. Taxable gain of $40,974 and ordinary income of $38,974
B. Taxable gain of $40,974 and ordinary income of $40,974
C. Taxable gain of $20,974 and ordinary income of $18,974
D. Taxable gain of $2,000 and ordinary income of $2,000

60. Farmer Bob sold a breeding cow on March 8, 2004 for $2,500. Expenses related to the sale were $250. Farmer Bob deducted $1,000 in costs of raising the cow during the years the cow was raised. What is Farmer Bob's gain (loss) on the sale of the breeding cow, without regard to the Uniform Capitalization Rules?

A. $(350)
B. $1,150
C. $2,250
D. None of the above

61. On January 1, 2004, Ben and Jerry each own 50% of the B&J Fudge partnership. B&J Fudge employs the cash method of accounting and receives $1,000 in interest income each month from an unrelated party loan receivable. On July 1, 2005, Jerry purchased 50% of Ben's partnership interest. There were no other changes in partnership interest for the remainder of the 2004 year. How much does Ben report as his ratable share of the interest income for 2004?

A. $7,500
B. $6,000
C. $4,500
D. $3,000

62. In 2004, John and George formed a partnership that began business on July 1, 2004. They spent $4,000 in legal fees for negotiating and preparing the partnership agreement, $2,000 for accounting services setting up the partnerships books, and $1,000 in commissions associated with acquiring assets for the partnership. They made a proper election to amortize organization expenses over a 60 month period. Assuming these are their only expenses in starting their partnership, what is the proper amortization expense for 2004?

A. $1,000
B. $600
C. $2,000
D. $1,200

63. Carol owns 50% of the capital interest in ABC Partnership and 50% of the profits interest in XYZ Partnership. In 2002 for $100,000, ABC Partnership sells land to XYZ Partnership, which XYZ Partnership will use in its trade or business. The ABC Partnership's adjusted basis in the land at the time of the sale was $120,000. In 2004, the XYZ Partnership sells the land to an unrelated third party for $160,000. How much gain will the XYZ Partnership recognize in 2004?

A. $30,000
B. $40,000
C. $60,000
D. $20,000

64. Archie sells his 50% interest in XYZ partnership to Hal for $5,000 cash. His outside basis in the partnership is $3,500. The partnership has inventory and a capital asset with respect to basis of $6,000 and $2,000. The respective fair market values of the inventory and capital asset are $8,000 and $1,000. Archie should properly recognize:

A. Ordinary income of $2,000 and a capital loss of $500
B. Capital gain of $1,500 on the sale of his partnership interest
C. Ordinary income of $1,500, the amount of cash he received
D. None of the above

65. Gary is a calendar-year eligible small employer and wishes to take advantage of the Credit for Small Employer Pension Plan Startup Costs. He incurred $2,000 in qualified startup costs in 2004 for an eligible plan that will become effective on January 1, 2005. What is Gary's Pension Startup Costs credit amount for calendar year 2004?
   A. $1,000
   B. $500
   C. $0 (he gets the credit in 2005)
   D. $2,000

66. John has three employees who are certified as members of a targeted group. Two of the employees worked for John for 2 months in 2002 and came back to work for John on January 1, 2004. The other employee began working for John on January 1, 2004. Each employee makes $1,000 per month. How much can John claim as qualified first year wages in computing the Work Opportunity Credit?
   A. $12,000
   B. $6,000
   C. $36,000
   D. $0

67. Rob and George own an office building that was built in 1975. They opened a tax return business in 2003 and made numerous renovations during 2004 to the building to bring it into compliance with the Americans with Disabilities Act of 1990. They had gross receipts of $750,000 dollars and ten full-time employees during 2003. They spent $15,000 in eligible access expenditures. What is the current year Disabled Access Credit?
   A. $5,000
   B. $1,500
   C. $14,750
   D. $7,500

68. Michael has a partnership interest with a zero basis. The partnership has inventory valued at $250,000. Michael's share of the ordinary income to be received from the sale of the inventory would be $10,000. In 2004, Michael sells his partnership interest for $30,000. Michael will report the following gain in 2004:
   A. $30,000 capital gain
   B. $20,000 ordinary gain and $10,000 capital gain
   C. $10,000 ordinary gain and $20,000 capital gain
   D. No gain or loss

69. Ryan runs a manufacturing business employing several people with young children. These employees require daycare as both parents work. He decided that, in order to make it easier for his employees to come to work each day, he would allocate some of the unused space in his manufacturing facility to a child care facility. In 2004, he incurred $20,000 in qualified childcare facility expenditures. He had no qualified childcare resource and referral expenditures and had no pass through credits. What is Ryan's credit for 2004?
   A. $20,000
   B. $2,000
   C. $10,000
   D. $5,000

70. In 2004, Linda sold her partnership interest for $25,000. Her adjusted basis at the time of the sale is $22,500 which includes her $12,500 share of partnership liabilities. When she initially invested in the partnership, she contributed $10,000 worth of equipment. There was no profit or loss at the partnership level at the time she sold her interest. What is the amount and nature of her gain or loss from the sale of her partnership interest in 2004?
   A. $7,500 ordinary loss
   B. $10,000 capital gain
   C. $12,500 ordinary gain
   D. $15,000 capital gain

71. Under a partnership agreement, Fred is to receive 30% of the partnership income, but not less than $8,000. In 2004 the partnership has net income of $20,000. What is the amount of guaranteed payment that can be deducted by the partnership in 2004?
   A. $8,000
   B. $6,000
   C. $2,000
   D. $0

72. The L&J Auto Parts Store operated as an accrual based partnership and filed a form 1065 for 2004. In addition to receipts from parts sales of $250,000, they had the following other items of income and expenses for 2004:

• Salaries	$(50,000)
• Insurance	$(5,000)
• Charitable Contributions	$(5,000)
• Licenses	$(5,000)
• Rental Income	$ 25,000
• Guaranteed payments to Partners	$(75,000)

What is the correct Ordinary Income or Loss that L&J should report on line 22 of their 2004 1065?
   A. $85,000
   B. $115,000
   C. $100,000
   D. $150,000

73. Farmer Judy is a calendar-year taxpayer who uses the cash method of accounting. She normally sells 200 head of sheep a year. Because of a drought, she sold 250 head of sheep in 2004. Farmer Judy realized $50,000 from the sale. The affected area was declared a disaster area eligible for federal assistance on March 12, 2004. How much, if any, income can Farmer Judy postpone to 2005?

A. $10,000
B. $50,000
C. $12,500
D. $0, since only sales because of flooding qualify for postponement

74. In 1998, XYZ Corporation issued qualified small business stock to you at a cost of $1,500. In 2004, you sold that stock for $50,000. How much of the gain on that sale is excludable from gross income?

A. $0
B. $7,500
C. $24,250
D. $48,500

75. You are a self-employer caterer. To encourage the continuation of an existing business relationship, you took one of your clients to a Broadway show. The visit to the show occurred directly after a substantial business discussion with that client. You paid a ticket broker $300 for two tickets to that show. The face value of each ticket was $100 ($200 total). What is your total deductible expense for both tickets?

A. $100
B. $150
C. $200
D. $300

76. Sandy and Buffy formed the S&B Partnership in November of 2004. They began business operations in December 2004. During 2004 they incurred the following costs:

- $2,500 to their attorney for negotiating and preparing the partnership agreement.
- $250 for filing fees for the partnership agreement.
- $1,000 to their CPA for services incident to the organization of the partnership.
- $500 in costs associated with transferring assets to the partnership.

What is the maximum dollar amount that S&B Partnership can elect to amortize as organizational costs?

A. $3,750
B. $4,250
C. $4,000
D. $1,750

77. Jim is a cash basis taxpayer and is an electrician. He received the following in 2004:

- Schedule C income of $25,000,
- Rental receipts of $6,000,
- 2005 advanced lease payments of $1,000 received in December, 2004,
- Dividend income of $500,
- A 2003 personal bad debt recovery of $1,000;,and
- $1,500 worth of electrical work in exchange for his friend installing a sprinkler system for him with a fair market value of $1,500.

How much does Jim have to report in his income for 2004?

A. $34,000
B. $35,000
C. $33,000
D. $31,000

78. John purchased a new gasoline-electric hybrid automobile on July 2, 2003, for $18,000. He also claimed a $2,000 clean-fuel vehicle deduction on his 2003 tax return for that vehicle. In 2003, John used this automobile only for personal purposes. On January 1, 2004, he began using the hybrid automobile exclusively for business purposes. The fair market value of the automobile on that day was $17,000. What is the automobile's depreciable basis as of January 1, 2004?

A. $15,000
B. $16,000
C. $17,000
D. $18,000

79. Sally exchanges an apartment building with an adjusted basis of $400,000 for an office building with a fair market value of $750,000. She also agrees to assume the mortgage on the office building in the amount of $200,000 and paid exchange expenses of $25,000. The other party agreed to assume Sally's mortgage on the apartment building in the amount of $125,000. What is Sally's adjusted basis in the new office building?

A. $425,000
B. $500,000
C. $625,000
D. $750,000

80. Rich, Inc., a calendar-year taxpayer employing the accrual method of accounting, acquired a business warehouse building in 2003 for $100,000. Rich, Inc. deducted $3,000 in warehouse asset depreciation expense on December 31, 2003. In January of 2004, Rich, Inc. incurred a $2,000 legal bill, successfully defending its title to the building. Later in the year a second floor office was added to the warehouse at a cost of $10,000. Rich, Inc. deducted $5,000 in warehouse asset depreciation expense on December 31, 2004. What is Rich, Inc.'s adjusted basis in the warehouse asset on January 1, 2005?

A. $100,000
B. $104,000
C. $110,000
D. $112,000

End of Part 2