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PART 2

SPECIAL ENROLLMENT EXAMINATION BOOKLET

September 25, 2002
1:30 p.m. to 4:30 p.m.

**Sole Proprietorships
And Partnerships**

*Official Use Only
(Declassified After September 25, 2002)*

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, 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 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. You adopt a tax year when you file your first tax return. You must adopt your first tax year by the due date (including extensions) for filing a return for that year.
2. Generally, you can use any combination of cash, accrual, and special methods of accounting if the combination clearly shows income and you use it consistently.
3. If you owe a business expense to a related party who uses the cash method of accounting, you will be able to deduct the expense if the relationship with that person ends before the expense is includible in the gross income of that person.
4. Generally, the basis of a patent you get for your invention is the cost of development, such as research and experimental expenditures (unless you deduct these as current business expenses), drawings, working models, and attorney and governmental fees.
5. When acquiring a sole proprietorship, a taxpayer must allocate the purchase price to the various assets acquired (equipment, building, intangible assets, land, etc.) based on the portion of the fair market value on the date of purchase of each asset.
6. A partially nontaxable exchange is an exchange in which you receive unlike property or money in addition to like kind property. The basis of the property you receive is the basis of the property you gave up decreased by any money you receive and any loss you recognize on the exchange.
7. If you acquire an asset in exchange for another asset and your basis for the new asset is calculated by using your basis in the old property, the holding period of the new property begins on the day of the exchange.
8. On February 1, 2001, Lucille acquired her replacement property before the sale of her rental was final. Lucille met all the time requirements for the exchange. Lucille transferred the replacement property to an exchange accommodation titleholder under a qualified exchange accommodation arrangement until she was able to finalize the sale of her rental property. She has a written agreement that was entered into within 5 days of the acquisition. This transaction generally will qualify for a tax-free exchange.
9. An inventory is necessary to clearly show income when the production of merchandise is an income-producing factor. If you must account for an inventory in your business, you must use an accrual method of accounting for your purchases and sales.
10. Patricia is a computer programmer and was laid off from Hard Drive Inc. due to downsizing. Hard Drive asked Patricia to work on a one-time project. They agreed to pay her a flat fee to create an advance product. The number of hours to complete this project is unknown and there is no guaranteed minimum payment for the hours spent. Hard Drive provides the specifications to Patricia for the product. Patricia uses her own high-end computer, and is not required to attend meetings held by the software engineering group. Patricia is an independent contractor.
11. A passenger automobile is any 4-wheeled vehicle made primarily for use on public streets, roads and highways and has an unloaded gross weight of not more than 6,000 lbs. Trucks and vans are classified as passenger automobiles if their weight is 6,000 lbs. or less when loaded.
12. The M&M partnership constructed a commercial building at a cost of \$350,000. M&M borrowed \$200,000 to help pay for the construction. The interest paid on the loan was \$16,000. M&M also borrowed money to purchase a truck to be used in the business. The truck cost \$30,000. M&M put \$6,000 down and borrowed \$24,000 and paid interest of \$2,400. M&M can deduct \$18,400 in interest expense on its tax return.
13. Charitable contributions made from your self-employed business account are deductible in full on Schedule C in the year of contribution.
14. A sale, exchange, or involuntary conversion of property held mainly for sale to customers is a Section 1231 transaction.

15. You can claim a casualty or theft loss of inventory, including items you hold for sale to customers, through the increase in the costs of goods sold by properly reporting your opening and closing inventories.
16. The amount you spend to board up your business against a storm is **not** part of your casualty loss.
17. Farm income averaging must be elected on a timely filed return (including extension) or later if the taxpayer receives approval from the Internal Revenue Service.
18. A domestic LLC with at least two members that does **not** file Form 8832 is classified as a partnership for Federal income tax purposes.
19. The partnership chooses how to treat the partner's share of foreign and U.S. possessions taxes, certain mining exploration expenses, and income from cancellation of debt.
20. Premiums for health insurance paid by a partnership on behalf of a partner for services as a partner are treated as guaranteed payments.

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. Which of the following dates would **not** be considered the end of a tax year?

- A. The last Friday in June.
- B. September 30, 2001.
- C. April 15, 2001.
- D. December 31, 2001.

22. Which of the following accounting methods is **not** an acceptable method of reporting income and expenses?

- A. If an inventory is necessary to account for your income, you must use an accrual method for purchases and sales. You can use the cash method for all other items of income and expenses.
- B. If you use the cash method for figuring your income, you can use the accrual method for figuring your expenses.
- C. Any combination that includes the cash method is treated as the cash method.
- D. You can use different accounting methods for reporting business and personal items.

23. The total basis for all properties qualifying for nontaxable exclusion that you receive in a partially nontaxable exchange is the total adjusted basis of the properties you give up with the following adjustments, **except**:

- A. Any additional cost you incur.
- B. Any money you receive.
- C. Unlike property you receive up to its cost on the date of the exchange.
- D. Any gain you recognize on the exchange.

24. Phil and Don are equal partners in the Hilldale Company. Hilldale has a fiscal year ending on January 31. Phil and Don file their individual tax returns on a calendar year basis. For the tax year ending January 31, 2001, Hilldale had taxable income from the active conduct of its business of \$100,000 of which \$60,000 was earned in 2000. How much of their partnership taxable income should Phil and Don each include in computing their taxable income limit for the 2001 tax year?

- A. \$50,000
- B. \$20,000
- C. \$30,000
- D. \$0

25. The Foster & Graves Partnership values its inventory under lower of cost or market value method. Under this method, what is the value of the ending inventory?

<u>Item</u>	<u>Cost</u>	<u>Market</u>
M	150	175
N	175	180
O	220	200

- A. \$525
- B. \$555
- C. \$545
- D. \$520

26. The taxpayer is a merchant who has purchased inventory items. He withdrew some of these items for personal use. He must:

- A. Increase his sales by the cost of the items withdrawn.
- B. Reduce the cost of purchases by the cost of the personal use items.
- C. Reduce the cost of purchases by the fair market value of the personal use items.
- D. Reduce beginning inventory by the cost of the personal use items.

27. Payments made by a partnership to a partner that are determined without regard to the partnership income are called:

- A. Guaranteed payments
- B. Minimum payments
- C. Ordinary income
- D. Capital gains

28. Alex and Arthur are equal partners in the A&R Partnership. Alex receives a guaranteed payment of \$ 5,000. The partnership had distributive net income (after deducting the guaranteed payment of \$5,000) of \$80,000. What amounts are subject to self employment tax?

<u>Alex</u>	<u>Arthur</u>
A. \$37,500	\$37,500
B. \$42,500	\$42,500
C. \$40,000	\$40,000
D. \$45,000	\$40,000

29. Bob works on the loading dock for the Loaden Partnership from 7:00 am to 3:00 pm, Monday-Friday. Susan, the full-time secretary, works a 4-day week. Max, the bookkeeper, is the sole proprietor of the Books-I-Keep Accounting Service and is a licensed accountant. Max works a different schedule each week for Loaden but is very conscientious and reliable. How many of these individuals are considered employees?
- A. 3
 - B. 2
 - C. 1
 - D. None.
30. A cafeteria plan is a written plan that allows employees to choose between receiving cash or taxable benefits instead of certain qualified benefits for which the law provides an exclusion from wages (deferral). Which of the following can be included in a cafeteria plan?
- A. Life insurance premiums.
 - B. Membership dues to athletic facilities.
 - C. Out-of-pocket medical expenses.
 - D. Tuition reduction.
31. The Adams & Baker Partnership bought James' B&B restaurant, which was located in an exclusive section of town. The goodwill associated with the purchase of this business was valued at \$60,000. Per Section 179, what is the number of years over which goodwill can be amortized?
- A. 5 years.
 - B. 10 years.
 - C. 15 years.
 - D. 20 years.
32. The D&L Partnership bought a truck for \$28,000 and a trailer for \$4,000 on January 10, 1998, to be used in the business. D&L uses the straight-line method and a 5-year life to recover its cost for tangible property. In 1998 and 1999, D&L took depreciation of \$6,400 and \$4,600 respectively. In January 2000, D&L discovered that it under-claimed depreciation of \$1,800 on its tax return for 1999. What can D&L do to recover the \$1,800?
- A. Claim \$8,200 depreciation in 2000.
 - B. Make a pro-rata adjustment to the basis of the equipment.
 - C. Amend the tax return for 1999.
 - D. It can't be recovered.
33. The K&L Partnership owned the following tangible property. Which one is **not** considered listed property?
- A. An automobile.
 - B. A cellular telephone.
 - C. A computer used for personal use 40% of the time.
 - D. A truck weighing 17,000 lbs designed to carry cargo.
34. Burt bought a 2001 BMW 525i for \$64,000 on March 2, 2001. He will use the automobile 100% of the time in his business. The recovery period for passenger autos is 5 years. What is Burt's depreciation for the year 2001?
- A. \$12,800
 - B. \$3,060
 - C. \$3,200
 - D. \$640
35. All of the following qualify for the depletion deduction **except**:
- A. Geothermal deposits.
 - B. Gas and oil.
 - C. Timber.
 - D. Land.
36. Mary, a seamstress, made loans of \$5,000 and \$1,000 to Buttons & Bows and Thread Bare, respectively. Both of these establishments are partnerships. Mary also made a loan of \$2,000 to her cousin Sarah, who was starting her own business as a proprietorship. The loans to both partnerships improved Mary's business, which was the reason Mary made the loans. If all three loans become uncollectible, what amount may Mary deduct as a business bad debt?
- A. \$5,000
 - B. \$6,000
 - C. \$1,000
 - D. \$2,000

37. Bart, a partner in the B&A Partnership attended the Comdex Computer Convention in Las Vegas. The partnership repairs and upgrades commercial computers for business use. At the convention, a new advanced computer hard drive was introduced that would make current machines run faster and more efficiently. Bart is responsible for purchasing hard drives for the computers used in the partnership. Bart's travel expenses excluding meals, were \$950. Part of that amount includes a rental car of \$100 incurred to visit his mother and \$50 for flowers and candy he bought for her. How much is deductible as a business expense?
- A. \$950
 - B. \$900
 - C. \$800
 - D. \$850
38. When an employer reimburses an employee for meals under an accountable plan while the employee is away from home, the employer must:
- A. Include 50% of the cost of meals as income to the employee.
 - B. Do nothing.
 - C. Deduct only 50% of the reimbursement on his/her tax return.
 - D. Add 100% of the meals as income to the employee.
39. In determining whether you are carrying on an activity for profit, all the facts and circumstances are taken into account. All of the following are factors to consider **except**:
- A. You are carrying on two different business activities. When you combine the income and expenses together, you have a net profit.
 - B. Your losses are due to circumstances beyond your control.
 - C. You can expect to make a future profit from the appreciation of the assets used in the activity.
 - D. You were successful in making a profit in similar activities in the past.
40. All of the following statements about foregoing the net operating loss (NOL) carry-back period are correct **except**:
- A. To make the election, you attach a statement to your tax return filed by the due date (including extensions) for the NOL year.
 - B. A taxpayer has three years to amend a prior year's return to include the election.
 - C. Once the election is made, the taxpayer cannot later revoke the election.
 - D. Once the election is made, you can use your NOL only in the 20 year carry-forward period.
41. Section 1245 property includes any property that is or has been subject to an allowance for depreciation or amortization. It includes all of the following types of property, **except**:
- A. Office equipment.
 - B. Client files.
 - C. Building elevator.
 - D. Storage facilities.
42. A taxpayer suffered an \$11,000 loss of inventory when his cooler malfunctioned. He had no insurance for this type of loss. He shows this loss on his tax return by:
- A. Taking a bad debt deduction of \$22,000, the amount he would have sold the inventory for.
 - B. Taking an ordinary loss on Form 4797 of \$11,000.
 - C. Taking a business loss on his Schedule C as reflected by an increase of \$11,000 in cost of goods sold.
 - D. Taking a loss of \$11,000 as a bad debt on Schedule D.
43. If you sell more livestock than you normally would in a year because of a drought, flood, or other weather related condition, you may be able to postpone reporting the gain from selling the additional animals until the next year. You must meet all of the following conditions to make the election **except**:
- A. You can show that, under your usual business practices, you would not have sold the animals this year except for the weather-related conditions.
 - B. The weather-related conditions caused an area to be designated as eligible for assistance by the Federal government.
 - C. You use the accrual method of accounting.
 - D. Your principal trade or business is farming.
44. Qualified farmers have the following choices to file their tax return without incurring any penalties:
- A. File and pay 100% of the tax due by March 1 each year.
 - B. File one estimated payment for two-thirds of the tax by January 15 and file and pay the balance by April 15.
 - C. File and pay the tax due by April 15 each year.
 - D. Both A and B.

45. If the partner's distributive share of a partnership item cannot be determined under the partnership agreement, it is determined by his or her interest in the partnership. The partnership interest is determined by taking into account all of the following items **except**:

- A.** The partner's relative contributions to the partnership.
- B.** The interests of all partners in economic profits and losses (if different from interests in taxable income or loss) and in cash flow and other nonliquidating distributions.
- C.** The amount of the partnership's nonrecourse liabilities.
- D.** The right of the partners to distributions of capital upon liquidation.

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. Mr. Jones has an adjusted gross income of \$30,000 and itemized deductions of \$6,000 for the 6-month period from January 1 through June 30, 2001. He is allowed to claim exemptions of \$11,600 (4 people). Mr. Jones received an approved change to his tax year and he must file a short tax year return. What is the taxable income amount that he must compute his short year return on?
- A. \$12,400
 - B. \$18,200
 - C. \$36,400
 - D. \$40,800

47. George purchased a business on May 31, 2001, for a lump sum price of \$1,400,000. The values of the assets on the seller's books were as follows:

	<u>Book Value</u>	<u>Fair Market Value</u>
Cash	\$200,000	\$200,000
Land	\$150,000	\$150,000
Building	\$300,000	\$450,000
Equipment	\$250,000	\$300,000
Covenant Not to Compete	\$0	\$100,000

George did not assume any loans. What is his basis for goodwill and the equipment?

<u>Goodwill</u>	<u>Equipment</u>
A. \$0	\$300,000
B. \$200,000	\$300,000
C. \$200,000	\$350,000
D. \$0	\$350,000

48. Larry purchased an office building and land on February 1, 2001, for \$1,000,000. No liabilities were assumed. The assessed value of the assets for real estate purposes at the time of the purchase were as follows:

	<u>Assessed Value</u>
Land	\$300,000
Building	\$500,000

What is the basis of the building?

- A. \$ 500,000
- B. \$ 600,000
- C. \$ 625,000
- D. \$ 700,000

49. Several years ago, you paid \$150,000 to build your home on a lot that cost you \$50,000. Before converting the property to rental use last year, you paid \$30,000 for permanent improvements to the house. You received a \$5,000 easement payment from the State of California for use of the land for a power line. The county indicates the FMV of the house is \$250,000 and the land is \$100,000. What is your basis for depreciation?

- A. \$150,000
- B. \$175,000
- C. \$180,000
- D. \$250,000

50. The Taft, Lincoln & Garfield partnership owned a vacant lot of land, which it used in its business. The partnership exchanged the lot for another vacant lot, which was used for business purposes. The adjusted basis of the old lot was \$20,000 (FMV \$31,000) and the adjusted basis of the new lot was \$19,000 (FMV \$30,000). The partnership incurred exchange expenses of \$500 for attorney fees and \$75 for deed fees to record the exchange. What is the basis of the new property on the books of the partnership?

- A. \$29,425
- B. \$20,000
- C. \$20,575
- D. \$19,575

51. Mike and Joe are equal partners in the Dandy Partnership. On January 1, 2000, the partnership, in a like-kind exchange, exchanged a building (adjusted basis \$150,000) used for business for another building (adjusted basis \$150,000) used for business. The new building had a mortgage of \$25,000, which Dandy assumed, and unpaid real estate taxes of \$2,600 which Dandy paid but was not reimbursed. What is the adjusted basis of the new building and what is the amount of depreciation assuming a 20-year life under the straight-line method?

<u>Adjusted Basis</u>	<u>Depreciation</u>
A. \$150,000	\$7,500
B. \$152,600	\$7,630
C. \$175,000	\$8,750
D. \$177,600	\$8,880

52. Fred exchanged his rental property with an adjusted basis of \$220,000 and an FMV of \$250,000 for a storefront worth \$230,000 and paid \$20,000 cash. Fred paid exchange costs of \$15,000 from his personal checking account. The property given up had a mortgage of \$100,000, that the other party in the trade assumed. Fred assumed a \$90,000 liability on the new property. What is Fred's **recognized** gain?

- A. \$0
- B. \$15,000
- C. \$20,000
- D. \$25,000

53. David owned a car, which he used in his business for the past two years. Its adjusted basis was \$13,500. David sells his car to a dealer for \$14,500. He then buys a new car for \$20,500 from the same dealer. What is David's basis in the new car?

- A. \$13,500
- B. \$14,500
- C. \$19,500
- D. \$20,500

54. Bill, a partner in Williams-Sonic, is a calendar-year taxpayer. Williams-Sonic's partnership year ends on June 30. For the partnership year ending June 30, 2001, Bill's distributive share of partnership profits is \$4,000. On August 20, 2001, Bill dies and his estate succeeds to his partnership interest. For the partnership year ending June 30, 2002, Bill and his estate's distributive share is \$6,000. What is Bill's self-employment income on Schedule E (Form 1040) for 2001?

- A. \$4,000
- B. \$5,000
- C. \$10,000
- D. \$7,000

55. The FX Partnership manufactures garden hoses for sale. In the month of January, its sales were \$80,000. During that month, the partnership had:

Beginning inventory, January 1	\$0
Raw materials purchased January 1	\$35,000
Raw materials shipping costs	\$1,585
Direct labor (production)	\$27,000
Factory overhead	\$6,000
Ending inventory, January 31	\$10,000

What is the cost of goods sold for the FX Partnership for the month of January?

- A. \$58,000
- B. \$59,585
- C. \$69,585
- D. \$53,585

56. Matt and Jason, partners in the M & J Partnership began business on June 15, 2001. The business incurred the following expenses prior to June 15th:

- Purchase of a commercial building for \$200,000.
- New electrical wiring \$27,000.
- New plumbing at a cost of \$75,000.
- Light fixtures, (not part of the wiring), replaced at a cost of \$6,500. These light fixtures were of the same quality as the previous ones.

What is the cost of improvements?

- A. \$108,500
- B. \$200,000
- C. \$275,000
- D. \$102,000

57. Mark is an engineer for the Peterson LTD Partnership. Peterson has an accountable travel expense plan. Mark incurred \$375 in travel expenses on a two-day business trip. When he returned to his tax home, he worked late and incurred \$90 for meals. Mark gave his employer an adequate accounting within a reasonable time and did not have any excess reimbursement. What amount, if any, must be included in Mark's W-2?

- A. \$375
- B. \$465
- C. \$0
- D. \$90

58. Ray owns a delivery truck and delivers bread to retailers locally for the Gorman Bakery. He owns his delivery route. In 2001, Ray received a W-2 with gross wages of \$30,000 in Box 1. Ray's Federal income tax rate is 15%. For the year 2001, Ray is considered what type of employee and had what amount withheld for Federal income tax (FIT)?

<u>Employee Type</u>	<u>FIT</u>
A. Statutory	\$4,500
B. Common law	\$4,500
C. Statutory	\$0
D. Common law	\$0

59. P&L Partnership purchased a building for commercial purposes on July 1, 2001, for \$200,000. Carpeting was installed at a cost of \$8,000 on August 30, 2001. Furniture was purchased at a cost of \$10,000 on September 1, 2001. Legal fees of \$700 and recording fees of \$100 were incurred at the time the building was purchased. What is the cost basis of the building?

- A. \$218,800
- B. \$200,000
- C. \$200,800
- D. \$218,000

60. James is a 50% partner in the A&M Partnership. The partnership bought a truck for \$24,000 in January 1998. James also owns a printing business that he operates part-time. In January 1998 he bought a color copier for \$1,200. Both the truck and the copier qualify for Section 179 deduction, which was taken in 1998. Two years later the truck and the copier were converted to personal use. The truck has a 5-year life and the copier has a 3-year life. What amount should be recaptured as ordinary income if James used straight-line depreciation on all of the equipment he purchased? (For 1998, the Section 179 deduction limitation amount was \$18,500.)

- A. \$7,600
- B. \$5,600
- C. \$13,200
- D. \$0

61. Mark, a 50% partner in the X&Y Partnership, uses the percentage method to compute his depletion allowance for the gas and oil property owned by the partnership. His allocable share of the property is \$100,000. The fair market value of the property is \$100,000 also. 65% of his taxable income for 2001 equals \$65,000. The percentage depletion rate is 15% for natural gas and oil sold. X&Y is a small producer, and the average daily production does not exceed the depletable oil and gas quantity. Mark's share of the gross sale of oil and gas deposits was \$30,000. What is Mark's depletion deduction for 2001?

- A. \$4,500
- B. \$9,750
- C. \$9,000
- D. \$5,250

62. The J&M partnership paid liability insurance on its building of \$2,200 for the year 2001. This represents a premium for one year. J&M also prepaid fire insurance premiums of \$2,400. The premium paid was for 2001 and 2002. What is the amount of insurance that J&M may deduct for 2001?

- A. \$2,200
- B. \$3,400
- C. \$4,600
- D. \$2,400

63. In 2001, Mark paid his first quarter real estate taxes of \$1,400 on his personal home. Mark paid real estate taxes on his unemployed brother-in-law's home of \$800. During the year, Mark was assessed a tax for trash pick-up of \$165. He also paid a tax of \$250 for improvements made by the town in his development, which increased the value of his property. Mark also withdrew the entire amount of \$10,400 from his traditional IRA of which \$2,400 was interest earned. Mark, in previous years, had taken deductions for his IRA contributions. Mark is 48 years old. What is deductible on his Form 1040 for real estate taxes and what is the tax penalty, if any, on the early withdrawal from his IRA?

Deductible Real Estate Tax on Schedule A	Tax on IRA
A. \$1,400	\$0
B. \$1,400	\$240
C. \$8,000	\$1,040
D. \$1,400	\$1,040

64. What is Sam's (a single taxpayer) net operating loss for the current year based on the following information?

- Wages from a part time job \$10,000
 - Interest on savings \$500
 - Net long term capital gain on sale of business asset \$5,000
 - Net loss from business \$20,000
(Gross income \$60,000 minus \$80,000 expenses)
 - Net short term capital loss on stock sale \$3,000
 - 2001 standard deduction \$4,550
 - 2001 personal exemption \$2,900
- A. \$4,500
 - B. \$5,000
 - C. \$7,500
 - D. \$14,950

65. A taxpayer sold his rental house for \$190,000 on May 2001. The depreciation taken under ACRS was \$67,840. If the taxpayer had used the straight-line method, the depreciation would have been \$64,960. How much Section 1250 gain did this taxpayer have when the house was sold?

- A. \$2,880
- B. \$64,960
- C. \$67,840
- D. \$110,000

66. A used car lot owner sold an adjacent lot on June 9, 2001, for \$125,000. He purchased this lot on August 6, 1998, for \$65,000. He did not pave this lot or make any improvements to it. He paid \$4,600 in closing costs at the sale. How much gain does he have, and what type of gain is it?

- A. \$55,400 Section 1250 gain.
- B. \$55,400 Section 1231 gain.
- C. \$4,600 Section 1245 gain, \$50,800 Section 1231 gain.
- D. \$55,400 Schedule D gain.

67. Fred bought new office equipment four years ago for \$1,000. In April, a fire destroyed the equipment. Fred estimates that it will cost \$1,200 to replace the equipment. Fred estimates the fair market value of the equipment was \$500. He had no insurance and at the time of the fire his adjusted basis was \$437. What is Fred's business loss?

- A. \$1,200
- B. \$1,000
- C. \$500
- D. \$437

68. A farmer sold a 3-year old raised dairy cow for \$600. It cost him \$75 for shipping and commissions to sell the cow. He reports this sale as follows on his tax return:

- A. A loss of \$700 on his Schedule F because he believed it cost him \$1,300 to raise the dairy cow.
- B. A Section 1245 gain of \$525 reported on Form 4797 Part III.
- C. A gain of \$525 reported on Schedule F as ordinary farm income.
- D. A Section 1231 gain of \$525 reported on Part I of Form 4797.

69. Sandy had the following total gross income for 2001:

Taxable interest	\$45,000
Dividends	\$1,000
Rental income (Schedule E)	\$1,500
Farm income (Schedule F)	\$75,000
Gain from sale of farm animals	\$5,000

How much of Sandy's gross income qualifies as gross income from farming?

- A. \$75,000
- B. \$80,000
- C. \$81,500
- D. \$127,500

70. F & J Partnership had the following income for the current year:

• Income from operations	\$170,000
• Tax exempt interest	\$10,000
• Dividends from foreign corporations	\$5,000
• Net rental Income	\$20,000

Partners Fred and Joe share the profits and losses equally. What is Fred's share of the partnership income (excluding all partnership items which must be accounted for separately)?

- A. \$85,000
- B. \$95,000
- C. \$97,500
- D. \$170,000

71. A partnership, in which Jane is a 50% owner had a profit of \$80,000. The partnership agreement provides for a 50-50 sharing of income. Capital is a material income producing factor. During the year, Jane performed services worth \$20,000. What is the total income Jane should report from the partnership?

- A. \$20,000
- B. \$40,000
- C. \$50,000
- D. \$80,000

72. Jason owns a 55% capital interest in ABC Partnership. His brother owns 60% interest in XYZ Partnership. ABC sold a piece of property with an adjusted basis of \$50,000 and a fair market value of \$55,000 to XYZ for \$45,000. What is ABC's **recognized** loss?

- A. \$0
- B. \$ 5,000
- C. \$5,500
- D. \$10,000

73. Under a partnership agreement, June is to receive 40% of the partnership income but not less than \$12,000 a year. The partnership has net income of \$20,000. What is the guaranteed payment that the partnership can deduct in figuring its ordinary income on Page 1 of Form 1065?

- A. \$0
- B. \$3,200
- C. \$4,000
- D. \$8,000

74. Sharon's basis in S & P partnership is \$185,000. In a complete liquidation of Sharon's interest in S & P, Sharon received the following:

	<u>S & P's Basis</u>	<u>Fair Market Value</u>
Cash	\$5,000	\$5,000
Building	\$50,000	\$100,000
Land	\$40,000	\$50,000

What is Sharon's basis in the building?

- A. \$50,000
- B. \$100,000
- C. \$116,667
- D. \$120,000

75. The adjusted basis in Carol's partnership interest is \$50,000. She receives a distribution of \$10,000 cash, land that has an adjusted basis of \$30,000 and a FMV of \$50,000.

What is Carol's adjusted basis in the land?

- A. \$20,000
- B. \$30,000
- C. \$40,000
- D. \$50,000

76. Mrs. Zee sold her 30% interest in LPM partnership for \$50,000. The partnership reports income on the accrual basis. Mrs. Zee's adjusted basis in the partnership interest was \$30,000. The partnership had no liabilities at the date of the sale. The partnership had the following assets at the time of Mrs. Zee's sale:

	<u>Adjusted Basis</u>	<u>Fair Market Value</u>
Cash	\$10,000	\$10,000
Accounts receivable	9,000	9,000
Inventory	7,000	10,000
Machinery & equipment	12,000	12,000
Accumulated depreciation	9,000	0
Land	<u>80,000</u>	<u>100,000</u>
Total assets	\$109,000	\$141,000

How much should Mrs. Zee report as capital gain and ordinary gain?

- A. Capital gain \$20,000; Ordinary gain \$0
- B. Capital gain \$16,400; Ordinary gain \$3,600
- C. Capital gain \$13,700; Ordinary gain \$6,300
- D. Capital gain \$-0-; Ordinary gain \$20,000

77. A company increased their research expenses by \$3,600. What is the maximum credit they qualify for on their tax return for tax year 2001?

- A. \$360
- B. \$900
- C. \$2700
- D. \$720

78. In 2001, the M&E Partnership bought a new electric motor vehicle to be used in its delivery service business. The vehicle qualifies for the electric vehicle credit. The vehicle cost \$50,000. No Section 179 deduction was taken in 2001. What is the electric vehicle credit for 2001?

- A. \$5000
- B. \$4000
- C. \$2500
- D. \$2000

79. The F&E Partnership spent \$100,000 on eligible access expenditures that qualify for the disabled access credit. The partnership had gross receipts of \$1 million and 30 full-time employees during the preceding tax year. What is the amount of the disabled access credit for the year 2001?

- A. \$5,000
- B. \$10,000
- C. \$250
- D. \$50,000

80. The Barrow and Jones partnership incurred qualified rehabilitation expenses of \$50,000 on a certified historic structure. What is the Rehabilitation Investment Credit before tax limitations are applied?

- A. \$5,000
- B. \$10,000
- C. \$7,500
- D. \$6,000

End of Part 2.