

2004

**SPECIAL ENROLLMENT
EXAMINATION**

Part 3

SPECIAL ENROLLMENT EXAMINATION BOOKLET

**September 23, 2004
9:00 a.m. TO 12:00 noon**

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



IRS

Department of the Treasury
Internal Revenue Service

publish.no.irs.gov

Publication 869 (Rev. 9.-2004)
Part 3
Catalog Number 32647X

Official Use Only
(Declassified after September 23, 2004)

This page left blank intentionally.

Special Enrollment Examination

Part 3

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

Instructions:

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

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

Important:

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

Read the examination questions carefully. All references are to the Internal Revenue Code as amended through December 31, 2003. Unless otherwise stated, all questions relate to the calendar year 2003.

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, 2005.

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.

Challenges must be received by the Office of Professional Responsibility on or before **October 22, 2004**. **Challenges must be on the form or in the format prescribed on www.irs.gov**

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 questions book and retain it for future comparison.

This page left blank intentionally.

Part 3
Section A:
Questions 1 – 20

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

1. For federal tax purposes, a Limited Liability Company must file a Form 8832, Entity Classification Election, in order to be taxed as a corporation.
2. The value of stock received for services is income to the recipient.
3. Betsy contributes \$60,000 in cash to a corporation. In return, Betsy receives from the corporation 100 shares of common stock and an antique art work with a fair market value of \$5,000. Betsy *may* be required to recognize gain upon receipt of the corporate property.
4. Hughes Corporation transferred shares of stock to Joe Brown in full satisfaction of a debt that Hughes Corporation owed to Joe Brown. Because this is a qualifying nontaxable exchange, no income or expense will be recognized by either party.
5. In starting up a new corporate business, the following expenditures were made:

State incorporation fees
Accounting services for setting up the corporation
Legal services for drafting the bylaws
Legal fees for terms of original stock certificates
Legal fees for minutes of organizational meetings
Analysis of potential markets
Advertising for the opening of the business
Salaries and wages for training new employees
Legal fees for transfer of the title of the building and land
Real estate tax expense on the real property

All of the above expenditures must be amortized over a 60-month period.
6. A corporation is treated as a small business corporation exempt from Alternative Minimum Tax (AMT) for its tax year beginning in 2003, regardless of its gross receipts for the tax year, if that year is the corporation's first year in existence.
7. If a corporation is required to use the Electronic Federal Tax Payment System (EFTPS) and fails to do so, it may be subject to a 10% penalty.
8. If you make a payment that may be a dividend but you are unable to determine whether any part of the payment is a dividend by the time you must file Form 1099-DIV, the entire payment must be reported as a dividend.
9. Distributions of stock and stock rights are tax-free to shareholders. Even if a shareholder has a choice to receive cash instead of stock rights, as long as the shareholder chooses to receive stock rights, the distribution will be tax-free.

10. A corporation will recognize a gain on the distribution of amortized property to a shareholder if the fair market value of the property is less than its adjusted basis.
11. Annual statement Form 1099-DIV must be furnished to recipients of a liquidating distribution only if cash is distributed as part of the liquidation.
12. Sarah owns all 100 outstanding shares of York Corporation stock. Sarah's basis for her stock is \$10,000. York Corporation has earnings and profits of \$500,000. York Corporation redeems 25 of Sarah's shares for \$85,000. Sarah must report a \$75,000 capital gain on her individual return.
13. A corporation that has individuals as shareholders and has less than 75 shareholders qualifies for S corporation status even if it has more than one class of stock.
14. S corporation deductions which are clearly and directly allocable to portfolio income are items separately stated to the shareholders.
15. A corporation that has elected S status and has filed Form 1120S for several years may terminate their S election by simply filing a Form 1120 in a subsequent year.
16. The character of the income that you receive in respect of a decedent is **not** the same as it would be to the decedent if he or she were alive.
17. Estimated tax payments are not required from a decedent's estate for any tax year ending before the date that is two years after the decedent's death.
18. A grantor type trust is a legal entity under applicable state law. Since the grantor or substantial owners have not relinquished complete control over the trust, it is not recognized as a separate taxable entity for income tax purposes.
19. You must file Form 706, United States Estate Tax Return, within 6 months after the date of the decedent's death, unless an extension of time to file is received.
20. In general, if you and your spouse elect gift splitting, the consent applies to all gifts made during the year.

Turn the page for Part 3, Section B.

This page left blank intentionally.

Part 3
Section B:
Questions 21 - 45

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

21. ABC, an eligible entity, made an election by filing Form 8832, Entity Classification Election, on December 15, 2001, to be taxed as a partnership effective for January 1, 2002. Under the general rule, what is the earliest date ABC can elect to be taxed as a corporation by filing another Form 8832?
- January 1, 2003
 - January 1, 2007
 - December 15, 2005
 - December 15, 2007
22. ABC Corporation's tax year ends on October 31, 2003. When is ABC Corporation's income tax return required to be filed?
- January 31, 2004
 - January 15, 2004
 - February 15, 2004
 - February 31, 2004
23. Abbot Corporation's tax year ends on June 30, 2003. If Abbot Corporation (a domestic corporation) timely files a Form 7004, Extension of Time to File, what is the extended due date of Abbot Corporation's income tax return for tax year ended June 30, 2003?
- March 15, 2004
 - March 30, 2004
 - April 15, 2004
 - May 15, 2004

24. John, Mark, Steve, and Tom **organize** the J M S & T Corporation by transferring the following:

Transferor	Asset	Transferor's Adjusted Basis	Fair Market Value	Consideration Received
John	Land	\$50,000	\$70,000	37 shares of stock
Mark	Equipment	\$35,000	\$40,000	22 shares of stock
Steve	Tools	\$45,000	\$35,000	19 shares of stock
Tom	Cash	\$40,000	\$40,000	22 shares of stock
				100 shares Total

The land contributed by John is subject to a mortgage in the amount of \$30,000. J M S & T Corporation assumes John's mortgage on the land. The 100 shares represent all of the outstanding stock of J M S & T Corporation. Which of the following is correct?

- The exchange qualifies for IRC § 351 nontaxable treatment.
- The exchange does not qualify for IRC § 351 nontaxable treatment.
- The exchange qualifies for IRC § 351 nontaxable treatment, but John must recognize \$30,000 of capital gain.
- The exchange qualifies for IRC § 351 nontaxable treatment, but John must recognize \$20,000 of capital gain.

25. Sky Corporation is a C Corporation. Jake owns 80% of all the outstanding shares of Sky Corporation stock. In 1996, Jake advanced funds to Sky Corporation as a loan. The loan instrument executed between Jake and Sky Corporation is a demand note. The principal balance due on the loan from Sky Corporation is \$300,000. After Jake demanded repayment of the outstanding loan on March 20, 2003, Sky Corporation transferred to Jake preferred stock with a fair market value of \$325,000 in settlement of the debt. Jake has the right to require Sky Corporation to redeem the preferred stock. Which of the following is true?

- The transfer of stock to Jake qualifies as a § 351 transfer.
- The transfer of stock is a nontaxable transaction because Jake is in control of the corporation.
- The transfer of stock to Jake is a § 1244 Qualified Small Business Stock transaction.
- Jake must recognize income on the transaction.

26. Iron Corporation incurred net short-term capital gains of \$40,000 and net long-term capital losses of \$90,000 during 2003. Taxable income from other sources was \$500,000. How are the capital gains and losses treated on the 2003 tax return, Form 1120?

- \$3,000 of the excess net long term capital losses are deducted currently and the \$47,000 remainder is carried forward indefinitely.
- None of the excess net long term capital losses are currently deductible, but may be carried back to the three preceding years and then forward five years as short term capital losses.
- Excess net long term capital losses are fully deductible in 2003.
- Excess net long term capital losses of \$50,000 are carried back two years and then carried forward 20 years as short term capital losses.

27. Which of the following statements about a controlled group of corporations is **false**?

- John Corporation owns 80% of the voting power and value of James Corporation stock. John Corporation and James Corporation are members of a controlled group.
- Allen Corporation owns 80% of the voting power and value of Brown Corporation stock. Brown Corporation owns 80% of the voting power and value of Cole Corporation. Allen Corporation, Brown Corporation, and Cole Corporation are members of a controlled group.
- Members of a controlled group are entitled to one \$50,000, one \$25,000, and two \$9,925,000 taxable income bracket amounts.
- Members of a controlled group may be either members of an affiliated group, or parent-subsidiary corporations, or brother-sister corporations.

28. The following statements regarding qualified personal service corporations are true **except**:
- 1) A qualified personal service corporation is taxed at a flat rate of 35%.
 - 2) A qualified personal service corporation must meet two tests: (a) one of performance of certain personal services, and (2) ownership directly or indirectly of at least 95% of the corporation's stock.
 - 3) The passive activity rules may apply to a personal service corporation if the corporation is not an S Corporation and the employee-owners own 10% of the fair market value of the personal service corporation's outstanding stock on the last day of the current tax year.
 - 4) Personal services are those performed in the fields of accounting, actuarial science, architecture, consulting, engineering, health (including veterinary services), law, and the performing arts.
 - A. 2 and 3
 - B. 3 only
 - C. 1 and 3
 - D. 4 only
29. Which of the following statements are true?
- 1) Members of a controlled group are entitled to one \$50,000, one \$25,000 and one \$9,925,000 taxable income bracket amount.
 - 2) When a controlled group adopts or changes an apportionment plan, each member must attach to its tax return a copy of its consent to this plan.
 - 3) Members of a controlled group may elect an unequal apportionment plan and divide the taxable income brackets as they want; however, each member must receive some of each taxable income bracket.
 - 4) If no apportionment plan is adopted, members of a controlled group must divide the amount in each taxable income bracket equally.
 - A. 1, 2, and 3
 - B. 2, 3, and 4
 - C. 1, 2, and 4
 - D. All of the above
30. The Susan Corporation was required to use the Electronic Federal Tax Payment System (EFTPS) in 2002 for payment of its employment and corporate income taxes. In 2003, the total deposits of taxes by The Susan Corporation were \$190,000. Which of the following is true?
- A. The Susan Corporation is required to use EFTPS in 2003.
 - B. The Susan Corporation may deposit corporate income tax payments and estimated tax payments with Form 8109, Federal Deposit Coupon mailed to an authorized depository or mailed to Financial Agent, Federal Tax Deposit Processing in St. Louis, Missouri for tax year 2003.
 - C. The Susan Corporation may send deposits directly to an Internal Revenue Service Office for tax year 2003.
 - D. The Susan Corporation is not required to participate in EFTPS, but may participate voluntarily for tax year 2003.
31. Common kinds of distributions by a corporation to shareholders are:
- A. Ordinary dividends
 - B. Capital gain distribution
 - C. Nontaxable distribution
 - D. All of the above
32. If a corporation transfers its stock to an employee as payment for services, the amount the corporation can deduct would be:
- A. The corporation's basis in the stock transferred.
 - B. The fair market value of the stock on the date of the transfer.
 - C. The fair market value of the stock when the corporation issues the W-2.
 - D. None of the above.
33. Rachel purchased 100 shares of Comet Corporation stock for \$500 in 2000. In 2003, Rachel received \$5,000 in a distribution from the partial liquidation of Comet Corporation. On her personal 2003 income tax return, Rachel must report income from this transaction as:
- A. Dividends
 - B. Capital gains
 - C. Other
 - D. None of the above
34. A fiduciary representing a dissolving corporation may request a prompt assessment of tax under Internal Revenue Code section 6501(d). This will limit the time the Internal Revenue Service has to assess additional tax or to begin court action to collect the tax from the date the fiduciary files the request to:
- A. Six months
 - B. Twelve months
 - C. Eighteen months
 - D. Twenty-four months
35. Which of the following will not shorten the period for assessing the tax when a fiduciary representing a dissolving corporation requests a prompt assessment of tax under Internal Revenue Code section 6501(d) by filing a form 4810?
- A. Where the taxpayer did not report substantial amounts of gross income
 - B. Where the taxpayer was filing a final return
 - C. Where the taxpayer filed a false return
 - D. Both answer A and answer C
36. An S corporation can be subject to which of the following taxes:
- A. Built-in gains tax
 - B. Excess net passive income tax
 - C. Both answer A and answer B
 - D. None of the above
37. An S corporation will be subject to Excess Net Passive Income Tax:
- A. Even if it has always been an S corporation
 - B. It has passive investment income for the year that is at least 20% of gross receipts
 - C. Both answer A and answer B
 - D. None of the above

38. An S corporation without prior C corporation earnings and profits must maintain the Accumulated Adjustments Account in order to:
- Determine the tax effect of any cash distributions.
 - Determine the tax effect of possible future post-merger distributions.
 - Determine the tax effect of distributions of property.
 - All of the above.
39. Income in respect of a decedent must **not** be included in the income of which of the following:
- The decedent's final 1040 filing
 - The decedent's estate (if received by the estate)
 - The beneficiary's filing (if the right to income is passed directly to and received by the beneficiary)
 - Any person to whom the estate properly distributes the right to receive it
40. In general, which of the following items are allowable deductions against a decedent's estate (Form 706)?
- Funeral Expenses
 - Mortgages (decedent's liability)
 - Charitable Bequests
 - All of the above
41. Which of the following tax credits are allowed on an Estate Tax return (Form 706)?
- Credit for foreign death taxes
 - Credit for Federal gift taxes (pre-1977)
 - Credit for tax on prior transfers
 - All of the above
42. In general, which of the following statements is **false**?
- An estate or trust may use the net operating loss not able to be used by the decedent in his final Form 1040 filing.
 - An estate or trust may carry its net operating loss back two years.
 - If a farming loss, the estate or trust may carry the loss back 5 years.
 - An estate or trust may elect to carry its net operating loss forward only.
43. Generally, in which of the following scenarios must a gift tax return be filed?
- You gave gifts to an individual (other than your spouse) totaling more than \$11,000.
 - You gave a gift of a future interest that was less than \$11,000.
 - You wish to split gifts with your spouse.
 - All of the above.
44. In general, on Form 709, you can claim a marital deduction for gifts to your spouse. Generally, you cannot take the marital deduction if the gift to your spouse is a terminal interest. You may elect to deduct a gift of a terminal interest (QTIP) if it meets three requirements. Which of the following is not a necessary requirement?
- No part of the entire interest is subject to another person's power of appointment.
 - Your spouse is entitled for life to all of the income from the entire interest.
 - The income is paid yearly or more often.
 - Your spouse has the unlimited power, while he or she is alive or by will, to appoint the entire interest in all circumstances.
45. Which of the following is **not** a characteristic of a skip person as it pertains to the GST tax?
- A natural person.
 - A person only one generation below the generation of the donor.
 - A person two or more generations below the generation of the donor.
 - A donee of a gift.

Turn the page for Part 3, Section C.

This page left blank intentionally.

Part 3
Section C:
Questions 46 - 80

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

46. Allen contributes machinery and real property to Jack Corporation that has been in existence for several years as follows:

<u>Asset</u>	<u>Adjusted Basis</u>	<u>Fair Market Value</u>
Machinery	\$100,000	\$150,000
Real Property	\$500,000	\$550,000

Jack Corporation has two classes of stock—one with voting rights and one without voting rights. In exchange for the machinery and real property, Allen receives stock with a fair market value of \$700,000. Immediately after the transfer, Allen owns 75% of the outstanding shares of corporate stock with voting power and 80% of the outstanding shares of each class of nonvoting stock of the corporation. Which of the following statements is true?

- A. \$100,000 gain is recognized by Allen
 B. No gain is recognized by Allen
 C. \$100,000 loss is recognized by the corporation
 D. \$100,000 gain is recognized by Allen and the corporation will recognize a loss in the amount of \$100,000
47. Fran transfers real property and a mortgage to a corporation in exchange for stock. Fran is in control of the corporation immediately after the transfer. The real property has a fair market value of \$500,000 and the mortgage transferred to the corporation is \$350,000. Fran has an adjusted basis in the real property of \$300,000. What is the amount of income required to be recognized by Fran, if any?
- A. \$350,000
 B. \$550,000
 C. \$50,000
 D. \$0
48. Hank transfers land with an adjusted basis of \$500,000 to Handy Hank's, Inc. In exchange, he receives shares of stock with a fair market value of \$300,000 and cash in the amount of \$175,000. Hank owns 51% of all the outstanding stock of Handy Hank's, Inc. immediately after the transfer. What is Hank's deductible loss on the transaction, if any?
- A. \$0
 B. \$25,000 loss
 C. \$200,000 loss
 D. \$325,000 loss
49. Larry owned 35 shares of Flower Corporation stock for which he had paid \$3,500. He sold this stock to his sister, Karen, for \$3,000. Karen later sold this stock to her cousin, Joe, for \$10,000. What is Larry's and Karen's recognized gain or loss, if any?
- A. \$0 loss for Larry and \$6,500 gain for Karen
 B. \$0 loss for Larry and \$7,000 gain for Karen
 C. \$500 loss for Larry and \$7,000 gain for Karen
 D. \$0 for Larry and \$0 for Karen
50. Carol Corporation and Brown Corporation are domestic corporations. The Carol Corporation owns 25% of the Brown Corporation. Carol Corporation's income from business for tax year 2003 is \$500,000 and business expenses are \$750,000. In addition to the income from business, Carol Corporation also received dividends from Brown Corporation in the amount of \$100,000. Carol Corporation's dividend received deduction is:
- A. \$70,000
 B. \$80,000
 C. \$100,000
 D. \$20,000
51. During 2003, Chris Corporation, a domestic corporation, had the following income, expenses and deductions:
- | | |
|--|----------|
| Gross receipts | \$95,000 |
| Net Capital Gains | \$10,000 |
| Expenses, not including Cash Contributions | \$65,000 |
| Contributions to qualified charities | \$20,000 |
| Net Operating Loss Carryover from 2002 | \$30,000 |
- What is the amount of Chris Corporation's allowable charitable contribution deduction for tax year 2003?
- A. \$1,000
 B. \$20,000
 C. \$4,000
 D. \$3,000
52. Ace Corporation had \$700,000 of gross income from business operations and \$725,000 of allowable business expenses. It also received \$50,000 in dividends from a domestic corporation for which it can take an 80% deduction, ordinarily limited to 80% of its taxable income before the dividends received deduction. What is Ace Corporation's Net Operating Loss?
- A. \$15,000
 B. \$0
 C. \$40,000
 D. \$65,000
53. Westover Health Services, Inc., a personal service corporation, has two shareholders. Westover was incorporated in 1988; and, has made irregular and infrequent distributions to its shareholders. The balance sheet of Westover Health Services, Inc. reflects unappropriated retained earnings in the amount of \$800,000 and no marketable securities. Westover has no specific, definite, and feasible plans for use of the earnings accumulation in its business. It has been determined that the amount needed to redeem a deceased shareholder's stock is \$500,000. What is the amount of Accumulated Earnings Tax that Westover Health Services, Inc. could be subject to for tax year ended December 31, 2003?
- A. \$7,500
 B. \$19,300
 C. \$22,500
 D. \$0

54. Everyday Corporation realized net book income in the amount of \$300,000 for tax year ended December 31, 2003. Included in the net book income are the following:
- | | |
|---|----------|
| •Federal Income Taxes | \$4,000 |
| •Excess Capital Losses over Capital Gains | \$10,000 |
| •Tax Exempt Interest Income | \$5,000 |
- What is Everyday Corporation's taxable income?
- A. \$290,000
B. \$304,000
C. \$280,000
D. \$309,000
55. Walnut, Inc. is a C corporation which was started in 1993. At the beginning of the current year, Walnut, Inc. has accumulated earnings and profits of \$100,000. During the current year Walnut, Inc. makes a \$5,000 distribution to its 100% shareholder in the first month of each quarter. At the end of the current year, Walnut, Inc. had \$150,000 in gross income and \$140,000 in allowable expenses from ordinary business operations. Walnut, Inc. also received \$5,000 in fully tax-exempt interest from state bonds. What part of the second quarter distribution is treated as a distribution of accumulated earnings and profits?
- A. \$1,250
B. \$2,500
C. \$3,750
D. \$5,000
56. Annual statement Form 1099-DIV must be furnished to recipients of which of the following:
- A. Liquidating distributions
B. Patronage dividends
C. Both answers A and B
D. None of the above
57. Edward owns 5 of the 1,000 outstanding shares of Wasco, Inc. stock. Edward purchased his 5 shares in 1998 for \$500 per share. During 2003, Wasco, Inc. stock trades at a high of \$2,000 per share. At the end of 2003, Wasco, Inc. has earnings and profits of \$1,000,000. Wasco, Inc. redeems all of Edward's 5 shares at the end of 2003 for \$1,500 per share. What amount of capital gain in 2003 must Edward report from the redemption of his Wasco, Inc. stock?
- A. \$2,500
B. \$0
C. \$7,500
D. \$5,000
58. Carol provides services in 1998 to Bragg Corporation. Her service contract with Bragg Corporation listed her fee at \$50,000 receivable in cash and/or stock. At the time her fee was due Bragg Corporation stock was trading for \$1,000 per share. Carol elected to receive \$30,000 in cash and 20 shares of Bragg Corporation stock. In 2001, the Bragg Corporation stock split increasing the number of Carol's shares to 40. In 2003, Carol sells 20 shares of her Bragg Corporation stock for \$1,500 per share. What is Carol's basis in the Bragg Corporation shares she still owns?
- A. \$10,000
B. \$20,000
C. \$30,000
D. \$40,000
59. In 1998, Ralph received 10 shares of White Corporation stock as a gift from his father. Ralph's father had originally paid \$10 per share for this stock. The stock was trading for \$20 per share at the time of the gift. In 2001, Ralph purchased an additional 20 shares of White Corporation stock for a price of \$30 per share. Ralph was charged a \$20 transaction fee on this purchase. In October of 2003, Ralph sold 20 shares of his White Corporation stock. Ralph cannot adequately identify the shares he disposed of. What is Ralph's basis in the White Corporation shares he still owns?
- A. \$100
B. \$200
C. \$310
D. \$360
60. At the end of 1995, Green, Inc. was a C corporation with \$50,000 in earnings and profits. Green, Inc. elected to be treated as an S corporation beginning with the 1996 year. At the end of 2003, Green, Inc. has a balance of \$10,000 in its Other Adjustments Account, a balance of \$20,000 in its Accumulated Adjustment Account, and a balance of \$50,000 in earnings and profits. Green, Inc. made cash distributions of \$25,000 to each of its 50% shareholders. Green, Inc. makes no elections relating to the source of distributions. What is the remaining Green, Inc. earnings and profits balance after the shareholder distributions?
- A. \$50,000
B. \$40,000
C. \$30,000
D. \$20,000
61. At the beginning of 2003, Tim had a \$2,000 stock basis in the S corporation, World, Inc. Tim owns 25% of the outstanding World, Inc. stock. At the end of 2003, World, Inc. reported on its schedule K, a \$16,000 ordinary loss, \$4,000 of interest income and \$2,000 in nondeductible expense. Tim has \$10,000 in flow-through reportable income from other S corporations. How much of the 2003 World, Inc. ordinary loss can Tim deduct on his personal return?
- A. \$0 in loss
B. \$2,500 in loss
C. \$3,000 in loss
D. \$4,000 in loss
62. Wanda owns 100% of S corporation, Milk Enterprises. At the beginning of 2003, she had a zero basis and an unused ordinary loss carry over from Milk Enterprises in the amount of \$5,000. During the year, Wanda secured a bank loan of \$10,000 on her personal residence and made a shareholder loan of that amount to Milk Enterprises. At the end of 2003, Milk Enterprises reported on its schedule K a \$1,000 ordinary loss and a \$3,000 cash distribution made to Wanda. Wanda has \$10,000 in flow-through reportable income from other S corporations. How much of Milk Enterprises' ordinary loss can Wanda deduct on her personal return?
- A. \$6,000 in loss
B. \$5,000 in loss
C. \$3,000 in loss
D. \$0 in loss

63. On January 1, 2003, Allen purchased 50% of the outstanding shares of an S corporation, Ball Enterprises, for \$1,000. At year end Ball Enterprises had \$5,000 in ordinary income, \$1,000 in net income from rental real estate, and had made \$2,000 in charitable contributions. Ball Enterprises had also paid \$700 to Allen's golf instructor and \$300 for a titanium driver Allen uses as a member at his country club. What is Allen's basis in Ball Enterprises at the end of 2003?
- A. \$2,000
B. \$2,500
C. \$3,500
D. \$5,000
64. On December 31, 2002, Walter had a \$2,000 basis in S corporation, Oak, Inc. Walter owns 50% of all outstanding Oak, Inc. stock. At the beginning of 2003, Walter contributed a patent that he had acquired for \$1,000 to Oak, Inc. During 2003 Oak, Inc. received \$5,000 in royalty income from that patent. Oak, Inc. also received \$2,500 in ordinary income and had \$500 in Internal Revenue Code section 179 deductions. At the end of 2003, Oak, Inc. returned ownership of the patent, which now had a fair market value of \$5,000, back to Walter. What is Walter's basis in Oak, Inc. at the end of 2003?
- A. \$1,000
B. \$1,500
C. \$2,500
D. \$5,000
65. Robert owns 50% of an S corporation, Blue Sky, Inc. and has a basis in that corporation of \$5,000 at the beginning of 2003. At the end of 2003, Blue Sky, Inc. reports ordinary income of \$10,000 and makes a distribution to Robert of a manuscript originally purchased for \$1,000 but now valued at \$8,000. How much income must Robert report on his personal 2003 return from this distribution?
- A. \$0
B. \$1,000
C. \$5,000
D. \$8,000
66. Mark owns 50% of an S corporation, Wick, Inc. and has a basis in that corporation of \$3,000 at the beginning of 2003. At the end of 2003, Wick, Inc. reports ordinary income of \$2,000 and makes a distribution to Mark of a truck with an adjusted basis of \$5,000 and a fair market value of \$7,000. How much income must Mark report on his personal 2003 return from this distribution?
- A. \$0
B. \$1,000
C. \$3,000
D. \$5,000
67. The decedent died on June 30, 2003. The decedent used the cash method of accounting, and a calendar year-end. What total amount of the following is includible in the decedent's final return (Form 1040)?
- Taxable Interest (earned equally all year) \$2,000
 - Dividends (declared on June 15, 2003 and received on July 10, 2003) 500
 - Final wages (received July 10, 2003) 2,500
- Total \$5,000
- A. \$1,000
B. \$2,500
C. \$4,000
D. \$3,500
68. Stanley, a decedent, had a \$2,000 net operating loss carryforward to his final year. The maximum allowable amount of net operating loss carryforward deducted on his final income tax return was \$500. What amount of the unused operating loss is carried forward to the Stanley's estate income tax return? (The decedent's final 1040 did not generate any additional net operating loss.)
- A. \$0
B. \$1,500
C. \$2,000
D. None of the above
69. John died on January 1, 2003. A calendar year was elected for his estate. No distributions were made by the estate. Based on the following, what is the taxable income (Form 1041) of the estate for the December 31, 2003, year end? Allow for the estate's exemption amount.
- Taxable interest \$2,000
 - Tax exempt interest \$1,000
 - Capital Gain \$3,000
 - Executor's fees \$ 300
- A. \$6,300
B. \$4,200
C. \$4,800
D. \$4,900
70. Under the terms of Robert's will, annual payments are to be made from the estate's income as follows:
- Spouse \$10,000
 - Daughter \$5,000
 - Son \$5,000
- There are no charitable contributions for the year and the distributable net income is \$10,000. How much should each beneficiary include in their respective gross income?
- | | <u>Spouse</u> | <u>Daughter</u> | <u>Son</u> |
|----|-------------------|-----------------|------------|
| A. | \$10,000 | \$0 | \$0 |
| B. | \$10,000 | \$5,000 | \$5,000 |
| C. | \$ 5,000 | \$2,500 | \$2,500 |
| D. | None of the above | | |

71. Given the following information, determine the value of Sam's gross estate. Sam is single:

	<u>FMV at date of death</u>
Cash	\$15,000
Life Insurance on Sam's Life (payable to his estate)	\$200,000
Jointly owned Property (Percentage includible-100%)	\$100,000

- A. \$315,000
 B. \$115,000
 C. \$265,000
 D. \$65,000

72. Given the following information, determine the value of Sara's gross estate:

	<u>FMV at date of death</u>
Beneficiary for life of a QTIP trust (Qualified terminal interest property)	\$2,000,000
Irrevocable trust (Sara was the grantor, but retained no interest in the trust)	\$1,000,000
Revocable grantor type trust (Sara was the grantor)	\$500,000

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

73. Based on the following information, what is the total allowable deduction against the decedent's estate?

•Mortgages and notes (receivable)	\$10,000
•Income in respect of a decedent	\$5,000
•Funeral expenses	\$12,000
•Attorney fees	\$20,000

- A. \$47,000
 B. \$32,000
 C. \$42,000
 D. \$10,000

74. Jim has elected to treat transfers (on behalf of his son) made by him during tax year 2003 to a qualified state tuition program as made ratably over 5 years. His total contribution to this plan, which he made during 2003 is \$55,000. He makes no other transfers during tax year 2003. What amount will be treated as a **taxable** gift in tax year 2003?

- A. \$55,000
 B. \$44,000
 C. \$11,000
 D. \$0

75. Ralph gave his aunt an antique clock during tax year 2003. He had purchased the clock for \$15,000 in 1999. The fair market value at the date of the transfer was \$21,000. What amount should be recorded on Form 709 as the value of this gift?

- A. \$15,000
 B. \$10,000
 C. \$21,000
 D. \$4,000

76. The following transfers were made by Ed during 2003. What is the gross amount of gifts to be included on Ed's 2003 Form 709 filing?

- \$15,000 to the United Way
 - \$12,000 to a political organization
 - \$20,000 paid directly to his nephew's college for tuition
 - \$13,000 paid directly to his niece for her college tuition
- A. \$33,000
 B. \$13,000
 C. \$28,000
 D. \$48,000

77. John made the following transfers during tax year 2003:

- To his neighbor in the amount of \$15,000
- To his nephew in the amount of \$12,000
- To his uncle in the amount \$13,000

All of the transfers are gifts that qualify for the annual exclusion. John files one Form 709 for tax year-end December 31, 2003. What is the total annual exclusion amount for gifts listed on John's 2003 Form 709 filing?

- A. \$40,000
 B. \$33,000
 C. \$11,000
 D. \$10,000

78. The Bob Trust is a Simple Trust. Per the information listed below, how much **taxable** income is passed through to the beneficiaries?

- Taxable interest \$1,000
 - Tax exempt interest \$1,000
 - Fiduciary fee \$400
- A. \$1,600
B. \$600
C. \$800
D. \$1,800

79. ABC Trust had the following income and deductions:

- Taxable interest \$5,000
- Capital gain \$1,000
- Fiduciary fee \$700

The trust had no tax exempt income for the year. Per the trust instrument, capital gains are **not** allocated to corpus. What is the distributable net income (DNI)?

- A. \$6,700
B. \$6,300
C. \$5,300
D. \$4,700

80. XYZ Trust is a complex trust. What is the trust's distribution deduction based on the following information (capital gains are allocated to income, there is no interest income, and there is no charitable contribution):

- Adjusted Total Income \$10,000
- Capital Gain (included in Adjusted Total Income) \$2,000
- Income required to be distributed currently \$5,000

- A. \$10,000
B. \$5,000
C. \$0
D. \$8,000

End of Part 3.

This page left blank intentionally.