2003

SPECIAL ENROLLMENT
EXAMINATION

Part 3

SPECIAL ENROLLMENT EXAMINATION BOOKLET

September 18, 2003
9:00 A.M. TO 12:00 NOON

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

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Special Enrollment Examination

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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 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.

Important:

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

Read the examination questions carefully. All references are to the Internal Revenue code as amended through December 31, 2002. Unless otherwise stated, all questions relate to the calendar year 2002.

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

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

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

Answer sheet: When you finish the examination, your answer sheet must be turned in to the monitor before leaving the room. You must turn in your answer sheet at the end of each test session or your test will not be graded and no credit received. **Answers noted in examination booklets will not be graded.** The examination will be graded in Washington, D.C., by the Office of Professional Responsibility, Internal Revenue Service. You will receive formal notification of your examination results on or about January 31, 2004.

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

General Grading Information:

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

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

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

Part 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. If a business entity has publicly traded shares or ownership interests, it must be taxed as a corporation for Federal income tax purposes.

2. Generally, unless specifically elected otherwise, a two-member limited liability company (LLC) will be classified as a corporation for Federal income tax purposes.

3. Generally, assets owned by an individual free of debt and properly contributed to a new corporation in exchange for stock in that company will not result in a taxable event to either the individual or the corporation as long as immediately thereafter, that individual is in control of the corporation.

4. The fair market value of stock received in exchange for personal services is **not** considered income to the recipient

5. If a group of transferors exchanges property for controlling stock in a corporation, each transferor must receive stock in proportion to his or her interest in the property transferred.

6. Ginger is a shareholder in Bell Corporation. She borrowed $1,000 from the Bell Corporation during the year and made no repayment. At year-end, Bell canceled the debt. The amount canceled is treated as a distribution to Ginger.

7. The Johnson Corporation owns 15% of the White Corporation. In 2002, Johnson Corporation received dividends on the White Corporation stock. Johnson Corporation may take a dividends-received deduction of 70% of those dividends.

8. The Bugs Corporation owns 100% of the stock of Grasshopper Corporation and 30% of the stock of Gnat Corporation stock. Grasshopper also owns 50% of Gnat stock. Each corporation has only one class of stock outstanding. The Bugs, Grasshopper and Gnat Corporations are members of the same controlled group.

9. When a new shareholder is added to an existing S corporation, the new shareholder must sign and submit Form 2553, Election by a Small Business Corporation.

10. Since the S corporation is a “pass through” entity for tax purposes, it is an informational return only and not subject to any taxes at the corporate level.

11. If an S corporation has no earnings and profits and distributes cash or property to a shareholder whose basis in their stock has been reduced to zero, all such distributions will be treated as ordinary income to the shareholder.

12. If a shareholder in an S corporation makes a loan to the corporation, he or she has effectively increased his or her basis in their corporate stock by the amount of the loan.

13. An S corporation may own shares of a C corporation, but a C corporation may not own shares of an S corporation.

14. John is a shareholder in an S corporation, which sent him a Form K-1 for the tax year ending 2002. The K-1 reflected ordinary income of $10,000 to John. However, there was no actual distribution of cash to any shareholder. Therefore, John may elect to treat the distribution for the year as a return of his original capital contribution.

15. Generally, income that is distributed to an estate beneficiary retains its character when reported on the beneficiary’s income tax return.

16. If a decedent’s estate includes property that was received from a person who died within 10 years before, or 2 years after the decedent received the gift, the decedent’s estate may be allowed a credit for estate taxes previously paid on the property.

17. A $20,000 contribution to a political organization for the use of the political organization must be reported on Form 709 United State Gift (and Generation-Skipping Transfer) Tax Return.

18. The election to split gifts may be made on an amended Form 709 if it is filed within 3 years after the due date of the original return.

19. The grantor of Trust A retained the right to the income of the trust and to determine the timing and amount of distributions. If the grantor distributes the income to his daughter, the daughter will pay tax on the income.

20. A simple trust must file a tax return only if it has taxable income.

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

Part 3
Section B
Questions 21 - 45

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

21. Which of the following types of domestic business entities, formed after 1996 cannot be taxed as a corporation?

1. An insurance Company
2. An association
3. A limited liability company with two or more active members
4. Entity that elects to be treated as a real estate mortgage investment conduit.

A. 4 Only.
B. 1, 2, and 4 Only.
C. 3 Only.
D. 2 Only.

22. Hinges, Inc. has a fiscal year end of June 30, 2002. What is the last date on which Hinges, Inc. can request an extension of time to file its tax return for the year ended June 30, 2002?

A. August 15, 2002.
B. September 15, 2002.
C. March 15, 2003.
D. April 15, 2003

23. Jose has formed the Salsa Corporation in March 2001 with only one class of voting stock and all stock has voting rights. In order to apply Internal Revenue Code section 351 treatment of non-recognition of any gain, Jose has to have what percentage of control of ownership of Salsa Corporation immediately after he transfers his assets to the corporation for stock?

A. At least 75% of the total voting stock.
B. At least 50% of the total voting stock.
C. At least 80% of the total voting stock
D. At least 20% of the total voting stock

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

A. Members of a controlled group are treated as one group to figure the applicability of the additional 5% and the additional 3% tax.
B. A parent corporation and its 80% owned subsidiary make up a controlled group.
C. All members of a controlled group need not use the parent corporation's tax year.
D. All of the above.

25. The Dana Corporation has two subsidiary corporations. In order to determine that the subsidiary corporations are in a controlled corporate group, which of the following must be true?

A. Ten or fewer persons (individuals, estates, or trusts) own at least 80% of the voting stock or value of shares of each of two or more corporations.
B. Ten or fewer persons own more that 50% of the voting power or value of shares of each corporation, considering a particular person's stock only to the extent that it is owned identically with regard to each corporation.
C. A persons' stock ownership is not taken into account for purposes of the 80% requirement unless that shareholder owns stock in all of the corporations considered to be in the group.
D. The subsidiaries must be located in the same state.

26. The Pine Corporation has just opened for business and has elected to amortize its startup expenses. What is the minimum number of months over which the start up costs can be amortized?

A. 60 Months.
B. 80 Months.
C. 6 Months.
D. 36 Months.

27. The Workit Corporation has a loss for the year 2001. In computing the net operating loss, which of the following statements is correct regarding either limiting or allowing deductions?

- **A.** The corporation can deduct any NOL carryovers from 2000.
- **B.** A corporation can take the deduction for dividends received, without regard to the limits based on taxable income that normally apply.
- **C.** A corporation cannot figure the deduction for dividends paid on certain preferred stock of public utilities without limits to its taxable income for the year.
- **D.** The corporation can deduct any NOL carryovers from prior years, subject to possible special limitations.

28. Regarding a corporation's election for S status, which of the following statements is correct?

- **A.** Generally, a properly completed and timely filed election for S corporation status must be made by the 15th day of the 4th month of the start of business or beginning of the entity's tax year.
- **B.** A filed election for S status will be deemed made timely, if it is included with the corporation's initial filing of its annual report of income on Form 1120S.
- **C.** A corporation cannot file for S status unless it has a tax year ending on December 31.
- **D.** None of the above.

29. ABC corporation commenced business on July 20, 2002. What is the final date at which ABC could file an election for S corporation status and be recognized as valid for the 2002 tax year?

- **A.** September 15, 2002.
- **B.** October 15, 2002.
- **C.** December 31, 2002.
- **D.** October 5, 2002.

30. If an S corporation, which has Accumulated Earnings and Profits (AE&P) is allowed to treat shareholder distributions as being made from the AE&P account how will those distributions be taxed, if at all?

- **A.** They will be taxed as dividend income.
- **B.** They will be taxed as ordinary earned income.
- **C.** They will be taxed as capital gain income.
- **D.** They will not be taxed, as it would be deemed a return of shareholder capital.

31. Mary is a 50% shareholder in an S corporation, which suffered a $100,000 loss for the tax year ending December 31, 2002. Mary's basis in her stock as of December 31, 2002 was $25,000. What can Mary do with the disallowed loss of $25,000?

- **A.** Carry back the loss three years to offset any personal taxes paid.
- **B.** Carry forward the loss indefinitely for use if her basis in her stock is sufficiently restored.
- **C.** Nothing. There is no provision for using disallowed losses from an S corporation, in any other tax year but that in which the loss occurred.
- **D.** Mary does not have a disallowed loss and can use the full $50,000 loss in the 2002 tax year.

32. Which of the following will **not** affect a shareholder's basis in his/her S corporation stock.

- **A.** Any Section 179 depreciation deduction, which is separately stated to the shareholder.
- **B.** Any tax exempt income earned by the corporation which is separately stated to the shareholder.
- **C.** Any Code Section 1245 capital loss which is recognized by the corporation and separately stated to the shareholder.
- **D.** None of the above.

33. On December 1, 2001, Raoul, a 55% shareholder in R & B, Inc., an S corporation, elected to terminate R & B's status as an S corporation, effective on January 1, 2002. It continued to operate as a C corporation. What would be the earliest date that it could again elect S status without IRS consent?

- **A.** January 1, 2004.
- **B.** December 1, 2006.
- **C.** January 1, 2006.
- **D.** Since election to terminate S status requires 100% of the outstanding shareholders' consent, Bob cannot make the election by himself.

34. Nevertoolate Corporation was established on January 1, 2002. 100% of the shareholders elected to adopt S status for the company and properly completed IRS Form 2553. However, the company's tax accountant did not file the form. On July 1, 2002, the new accountant discovered the filing omission. Select the best available remedy for the corporation to elect S status from the following:

- **A.** File the Form 2553, as originally prepared, on or before the end of the first tax year of the corporation.
- **B.** Prepare a new Form 2553 and adopt a "short year" period for S status.
- **C.** File the original Form 2553, on or before the due date of the initial return "pursuant to Rev-Ruling 98-55" and show cause as to why the election is being filed late.
- **D.** The company may file the prepared Form 2553, however, consent for S status will not be effective earlier than January 1, 2003.

35. John, a self-employed carpenter, died on January 8, 2002. Which of the following, if allowable, could be deducted on John's final Form 1040?

- **A.** Unused net operating loss carryover from 2001.
- **B.** The full amount of his personal exemption (without pro-ration).
- **C.** Medical expenses paid by the estate within one year of death.
- **D.** All of the above.

36. A calendar year estate came into existence November 12, 2001. It had a tax balance due of $15,000 on the 2001 return. The estate executor expects to have a $10,000 balance due on the 2002 tax return. The estate will not be finalized until 2003. Income is received evenly throughout the year, and there is no withholding. The executor is **required** to make estimated payments on:

- **A.** April 15, 2002; June 17, 2002; September 16, 2002; January 15, 2003.
- **B.** December 31, 2002 if the return is filed on or before February 28, 2003.
- **C.** Either A or B.
- **D.** No estimated payments are required.

37. The John Q estate fiscal tax year runs from April 1, 2001 to March 31, 2002. The estate made distributions to beneficiaries on December 12, 2001 and March 15, 2002. Assuming the estate has taxable income, in what year will its beneficiaries be required to report taxable distributions?

- **A.** 2001.
- **B.** 2002.
- **C.** Both 2001 and 2002.
- **D.** Neither 2001 nor 2002.

38. Unless an extension is received, Form 706 Estate Tax Return must be filed:

- **A.** By the 15th day of the fourth month following the month of death.
- **B.** Within 9 months of the date of death.
- **C.** Within 6 months of the date of death.
- **D.** No later than the due date of the estate income tax return.

39. All of the following items can be claimed as deductions against a decedent's estate **except**:

- **A.** Specific bequest to son.
- **B.** Executor's fees.
- **C.** Legal fees to settle estate.
- **D.** Charitable bequests.

40. Which of the following amounts paid may be claimed as a credit on the estate tax return:

- **A.** Charitable contributions.
- **B.** Generation-skipping transfer tax.
- **C.** State death taxes paid.
- **D.** Earned income credit.

41. The Bordman Trust, an ongoing trust, was created in 1990. It has a net operating loss in 2002. Which of the following statements is/are true regarding the trustee's choices for claiming the loss?

- **A.** Carry the NOL back to 1990.
- **B.** Waive the five year carryback and carry the NOL back two years.
- **C.** Waive both the two year and the five year carryback periods and pass the NOL through to beneficiaries.
- **D.** NOL carryback is not available to trusts.

42. The Emerson estate has distributable net income (DNI) of $20,000 on its 2002 return. The only distribution the executor made during the year was $10,000, paid to the decedent's son, Sam. The distribution was made to fulfill a bequest stated in the decedent's will, which required that one payment of $10,000 be paid to Sam within six months of Mr. Emerson's death. Which of the following statements is true regarding who will pay tax on the estate's income:

- **A.** Sam must pay tax on $10,000.
- **B.** Sam must pay tax on $20,000.
- **C.** Sam is not required to pay tax on the distribution.
- **D.** None of the above.

43. The annual gift tax exclusion amount is allowed on which of the following gifts:

- **A.** $30,000 cash to Friend A.
- **B.** $30,000 car to Friend B.
- **C.** $30,000 remainder interest to Friend C.
- **D.** Both A and B.

44. The Morrison Trust requires that all trust income be distributed at least annually. There are no provisions for charitable contributions. To be treated as a simple trust, what must also be true?

- **A.** Trust income can consist of interest and dividends only.
- **B.** There were no other distributions of corpus in the current year.
- **C.** All beneficiaries must be U.S citizens or resident aliens.
- **D.** All of the above.

45. Christopher wants to create a revocable grantor trust that will own all of his stocks and rental properties. Which statement regarding income of the trust is true?

- **A.** Christopher will be taxed only income that is distributed to him.
- **B.** Christopher will be taxed on all income of the trust, regardless of distributions.
- **C.** State law will determine how much of the trust income is taxable to Christopher.
- **D.** If the rental income is passive, it will not be taxable to him.

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

Part 3
Section C:
Questions 46—80

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

46. John was one of five incorporators of Builders, Inc. Each received stock valued at $100,000. The other four shareholders each contributed $100,000 for their stock. John contributed $50,000 and his services to build the corporate headquarters. He valued his services at $50,000. How much income must John recognize on this transaction?

- **A.** $100,000 of ordinary income.
- **B.** $50,000 of ordinary income and $50,000 of capital gain income.
- **C.** No income recognition.
- **D.** $50,000 of ordinary income.

47. Pietro transfers property worth $50,000 to Vino, Inc. and, also, provides personal services worth $5,000 in exchange for stock valued at $55,000. Immediately after the exchange Pietro owns 90% of Vino, Inc.'s outstanding stock. What is Pietro's income recognition, if any?

- **A.** $55,000 Capital Gain, $ - 0 - Ordinary Income.
- **B.** $ - 0 - Capital Gain, $5,000 Ordinary Income.
- **C.** $ - 0 - Capital Gain, $50,000 Ordinary Income.
- **D.** $5,000 Capital Gain, $ - 0 - Ordinary Income.

48. Jenny transferred a factory building with an adjusted basis of $70,000 and a fair market value of $110,000 to the Crystal Corporation in exchange for 100% of Crystal Corporation stock and $20,000 cash. The building was subject to a mortgage of $25,000, which Crystal Corporation assumed. The fair market value of the stock was $75,000. Which is the amount of Jenny's realized gain and recognized gain?

	Realized	Recognized
A.	$25,000.	$25,000.
B.	$50,000.	$40,000.
C.	$50,000.	$20,000.
D.	$35,000.	$20,000.

49. Mary owns a farm with a FMV of $500,000 and a mortgage of $200,000. She exchanged the farm for stock in a transfer under IRC section 351. What is her basis in the new stock?

- **A.** $300,000.
- **B.** $200,000.
- **C.** $500,000.
- **D.** $700,000.

50. Joyce and Edward combine their sole proprietorships by forming the Lair Corporation. Joyce transfers land and a building having a combined $50,000 adjusted basis and a $100,000 FMV to the corporation in exchange for 40% of the Lair Corporation stock. Edward transfers equipment with a $60,000 adjusted basis and a $150,000 FMV to the corporation in exchange for 60% of the Lair stock with a par value of $10. Joyce and Edward received no other property then the Lair stock. What is Edward's recognized gain on this transaction?

- **A.** $60,000.
- **B.** $90,000.
- **C.** $ - 0 -.
- **D.** $150,000.

51. Bob and Charles, as a group, transfer a building with a basis of $100,000 to the ABC Corporation in exchange for 66.67% of each class of stock with a fair market value of $300,000. The other 33.33% of the stock was already issued to Alice. What is the gain, if any, that Bob, Charles, or the ABC Corporation must recognize?

- **A.** Bob and Charles, $ - 0 -, ABC Corporation $ - 0 -.
- **B.** Bob and Charles, $ - 0 -, ABC Corporation $300,000.
- **C.** Bob and Charles, $200,000, ABC Corporation $ - 0 -.
- **D.** Bob and Charles, $ - 0 -, ABC Corporation $200,000.

52. Mr. Smith and Mr. Jones each transfer property with a basis of $10,000 to a corporation in exchange for stock with a fair market value of $30,000. The total stock received by them represents 75% of each class of stock of the corporation. The other 25% of each class of stock was issued earlier to Mr. Brown, an unrelated person. The taxable consequences are:

- **A**. None because it is transfer of property for stock.
- **B**. Mr. Smith and Mr. Jones each recognize a gain of $20,000.
- **C**. Mr. Smith and Mr. Jones each recognize a gain of $30,000.
- **D**. 80% of the transaction is recognized as a taxable gain.

53. Sandra sold her Lavender Corporation stock to her mother Beth for $8,000. Sandra's cost basis in the stock was 15,000. Beth later sold this stock to Harry, an unrelated party, for $20,000. What is Sandra's **recognized** gain or loss?

A. $2,000.
B. $7,000.
C. $7,500.
D. $ - 0 -.

54. The Green Corporation owns 25% of the stock of the Cande Corporation. In 2002, Green Corporation received $10,000 dividends from the Cande Corporation stock. Assuming no other limitations apply, Green Corporation's dividends-received deduction is:

A. $7,000.
B. $8,000.
C. $2,000.
D. $ - 0 -.

55. The Spring Corporation's income from business in the year 2001 is $500,000 and business expenses of $750,000. The corporation also received dividends from the Acme Corporation of $100,000. The Spring Corporation owns 25% of the Acme Corporation. What is the Spring Corporation's Net Operating Loss for the year 2000?

A. ($150,000).
B. ($0).
C. ($220,000).
D. ($230,000).

56. The Cole Corporation distributes $75,000 in cash along with land having a $50,000 adjusted basis and a $60,000 FMV to its shareholder. What gain, if any, must Cole Corporation recognize?

A. $10,000.
B. $75,000.
C. $ 25,000.
D. $ - 0 –.

57. Wargo Corporation has two equal shareholders, Karen and Bob. Each shareholder owns 10 shares of Wargo stock and has owned the stock for several years. Each share has a $100 basis and a $150 FMV. Wargo, which has sufficient E&P redeems 5 shares from **each** shareholder at the $150 FMV. What income, if any, do **Karen and Bob** recognize as a result of the redemption of Wargo Corporation stock?

A. $750. Dividend income.
B. $1,500 Capital gain.
C. $ - 0 –.
D. $1,000 Dividend income.

58. Wargo Corporation has two equal shareholders, Karen and Bob. Each shareholder owns 10 shares of Wargo stock and has owned the stock for several years. Each share has a $100 basis and a $150 FMV. Wargo, which has sufficient E&P, redeems 5 shares **from Bob** at the $150 FMV. What income, if any, does **Bob** recognize as a result of the redemption?

A. $750.
B. $250.
C. $500.
D. $1,000.

59. During the 2002 calendar year, the Lance Corporation made a $40,000 cash distribution to its sole shareholder. Lance Corporation's current year earnings and profits (as of the close of the year and without reduction for distributions during the year) is $25,000. Accumulated earnings and profits is $10,000. What amount of dividend should be reported on Form 1099-DIV issued to the shareholder for the year 2002?

A. $ 40,000.
B. $ 5,000.
C. $ 0.
D. $35,000.

60. Which of the following statements regarding distributions of stock is **not** true?

A. Distributions of stock and stock rights are never treated as property.
B. Stock rights are distributions by a corporation of rights to acquire its stock.
C. Distributions of stock dividends and stock rights are generally tax free to shareholders.
D. Expenses of issuing a stock dividend are not deductible but must be capitalized.

61. The West Corporation distributes property with a basis of $1,000 and a fair market value of $4,000 subject to a liability of $6,000 to Jeff, a shareholder. What is the gain or loss, if any, the West Corporation must recognize as a result of the distribution?

A. $3,000 gain.
B. $1,000 loss.
C. $5,000 gain.
D. $ - 0 -.

62. The Warren Corporation, decided to distribute 10 additional shares of its own $10 par stock to each of its 5 employees at year end as a reward for a profitable year. Each employee was to receive 10 shares with a fair market value of $200 per share. Employees were offered a choice of cash or stock dividend. What is the tax effect to Warren Corporation of this distribution?

A. $0, distributions are not taxable.
B. $9,500 gain in distribution of stock.
C. $10,000 deduction for salaries expense.
D. Both B and C.

63. In 2002, pursuant to a complete liquidation, Richards Corporation distributes the following to a shareholder: Inventory, basis $10,000, FMV $20,000; and land held as an investment, basis $5,000, FMV $40,000. The land is subject to a $30,000 liability. What are the amounts and character of income to be recognized by Richards Corporation?

A. $10,000 ordinary income; $35,000 capital gain.
B. $10,000 ordinary income; $65,000 capital gain.
C. –0- ordinary income; $0 capital gain.
D. $10,000 ordinary income; $5,000 capital gain.

64. Colin Corporation acquired 100% of the Lebeck Corporation stock several years ago for $100,000. In 2002 (the current year) Lebeck corporation was liquidated, and assets having a $130,000 FMV and $50,000 tax basis were transferred to Colin Corporation. Immediately following the liquidation of Colin Corporation sells the assets for $130,000. What is gain or loss if any will Colin Corporation recognize from the sales of the assets?

A. $30,000 gain.
B. $80,000 gain.
C. ($50,000) loss.
D. $0 none.

65. ACME, Inc., a widget manufacturer, is an S Corporation, which converted from C corporation status in 1997. During its years as a C corporation, it realized substantial earnings and profits and invested in real estate, equity markets, and term certificates of deposit. For the tax year ending December 31, 2002 the company realized the following income:

- $40,000 net income from the production of widgets
- $20,000 net income from real estate rentals
- $5,000 net interest income

Assuming that the highest corporate tax rate is 40%, calculate the amount of tax, if any, that the S-Corporation will have to pay with their annual return.

A. $4,000.
B. $6,000.
C. $22,000.
D. $ - 0 -.

66. We Converted, Inc. elected S corporation status in 1999, after 10 years as a C corporation. At the date of conversion, the company had a $50,000 Net Operating Loss (NOL) carryover, which it incurred in 1998, and a $25,000 capital loss carryover. In 2002, the company sold a vacant piece of property it owned since 1990. The sales price of the property was $100,000 and an original cost of $25,000. Given the circumstances, as stated above, which of the following statements is correct.

A. No amount of gain is taxable to the S Corporation, because the total of the NOL and Capital Loss carryover ($75,000) can be used to offset the capital gain on the sale of the property.
B. Only $50,000 of the $75,000 capital gain is subject to S corporation tax.
C. $75,000 of the capital gain is taxable, since the S corporation cannot succeed to the beneficial tax attributes of a former C corporation.
D. No amount of gain is taxable to the S corporation because all income items are separately stated to the shareholders.

67. Bob and Sally, unmarried taxpayers, each owned 50% of Lostalot, Inc., an S corporation. The corporation had a $50,000 operating loss for the tax year ending December 31, 2002. As of 12-31-01, Bob's basis in his stock was $15,000 and Sally's was $5,000. During the 2002 tax year, Sally mortgaged her home for $25,000 and loaned the money to the corporation. Although not personally liable, Bob told her not to worry and that if anything happened, he would help pay the mortgage debt. Calculate the amount of allowable loss deduction each shareholder would be able to recognize on their individual 2002 tax returns.

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

68. John, a retired insurance salesman, died in 2002. Using the information below, determine the amount of income in respect of a decedent that must be reported on the estate's Form 1041 income tax return.

	Received Before Death	Received After Death
Wages	$10,000	$3,000
Renewal commissions	$20,000	$7,000
Life insurance (on John's life)		$100,000

- **A.** $3,000.
- **B.** $10,000.
- **C.** $110,000.
- **D.** $170,000.

69. The ABC Trust has only nondisabled beneficiaries. The trust is not required to distribute its net income to its beneficiaries, but it does make discretionary distributions. From the information below, determine the amount of taxable income that will be taxed to the trust on its 2001 return (deduct the exemption amount before selecting the answer):

Adjusted total income	$70,000
Distribution deduction	$40,000
Exemption	?

- **A.** $29,400.
- **B.** $29,700.
- **C.** $29,900.
- **D.** $30,000.

70. The Marker Estate did not make any distributions to beneficiaries in 2002. From the information below, determine the estate's taxable income after allowing the estate exemption amount.

Taxable interest	$ 1,000
Gain on sale of stock	$ 5,000
IRA distribution ($0 basis)	$50,000
Executor's fees	$ 5,000

- **A.** $400.
- **B.** $11,600.
- **C.** $50,400.
- **D.** $55,600.

71. John, a single taxpayer, died on March 3, 2002. Based on the following information, determine the value of John's gross estate.

	FMV on date of death
Life insurance on John's life (payable to John's estate)	$250,000
John's revocable grantor trust	$700,000
Stock given to John's son in 2001 (no gift tax was paid)	$ 50,000

- **A.** $250,000.
- **B.** $700,000.
- **C.** $950,000.
- **D.** $1,000,000.

72. When Lisa's husband died in 1999, he set up a qualified terminable interest property (QTIP) trust, naming Lisa as the beneficiary for her life. Lisa died in 2002. Given the following information, determine the value of Lisa's gross estate.

	FMV on date of death
Lisa's revocable grantor trust	$ 750,000
QTIP trust	$1,000,000

- **A.** $ - 0 -.
- **B.** $750,000.
- **C.** $1,000,000.
- **D.** $1,750,000.

73. Laura's gross estate equals $2,000,000. Given the following information, determine Laura's taxable estate:

Charitable contribution specified in Laura's will	$100,000
Funeral expenses	$ 10,000
Medical expenses claimed on Laura's Form 1040	$ 20,000

A. $1,870,000.
B. $1,880,000.
C. $1,890,000.
D. $2,000,000.

74. John made several transfers during 2002. In January, he paid $6,000 of tuition directly to State University for his friend, Sam. He gave his niece, Sally, $5,000 for her school tuition. In addition, in May, he also gave the following graduation gifts:

Cash to his friend, Sam	$7,500
Cash to his niece, Sally	$5,000

He gave no other gifts during the year. From the information above, must John file a gift tax return, and why?

A. No, total gifts to any one individual during the year do not exceed $11,000.
B. No, each transfer was under $11,000.
C. Yes, total gifts given during the year exceed $11,000.
D. Yes, total gifts to Sam exceed $11,000.

75. Tom, who is married, gave a vase worth $40,000 to his sister, Julie. Tom's basis in the vase is $10,000. What amount will Tom report as the value of the gift on Form 709?

A. $10,000.
B. $20,000.
C. $30,000.
D. $40,000.

76. Andrew gave several taxable gifts to friends and relatives during 2002. He also gave $50,000 to his favorite charity, a qualified 50% organization. When he files his 2002 Form 709, what amount will Andrew enter as the net charitable deduction (Schedule A, Part 3, line 11)?

A. $14,000.
B. $25,000.
C. $39,000.
D. $50,000.

77. Trust A is a simple trust with two equal beneficiaries, Jim and Randy. In 2002, the trust had $30,000 of distributable net income, all from taxable interest. During the year, the trust distributed $5,000 to Jim and $10,000 to Randy. Based on this information, the trustee should issue K-1's as follows:

A. Jim $5,000; Randy $10,000.
B. Jim $15,000; Randy $15,000.
C. Jim $10,000; Randy $20,000.
D. Jim $30,000; Randy $30,000.

78. Trust Y has taxable interest and dividends of $9,000 and tax exempt interest of $1,000. The only expense the trust incurred was a trustee fee of $500. Based on this information, what amount of adjusted tax-exempt interest is included in the trust's distributable net income?

A. $8,550.
B. $500.
C. $950.
D. $1,000.

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

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

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

80. Trust B has distributable net income of $60,000, which includes $5,000 of tax-exempt income. The trustee distributed $75,000 to the trust's sole beneficiary. What amount will be shown as the distribution deduction on the trust's Form 1041?

A. $55,000.
B. $60,000.
C. $70,000.
D. $75,000.

End of Part 3.