

Question 1

Which of the following entities is **not subject** to federal income tax at the entity level?

- a. C corporation
- b. S corporation
- c. Personal service corporation
- d. Regular corporation

✅ **Answer:** b. S corporation

📘 **Explanation:** S corporations are **pass-through entities**; income flows through to shareholders and is taxed on their individual returns.

Question 2

Which of the following items is **not deductible** as a business expense?

- a. Advertising expenses
- b. Bribes and kickbacks
- c. Office rent
- d. Employee salaries

✅ **Answer:** b. Bribes and kickbacks

📘 **Explanation:** Illegal payments (bribes, kickbacks, fines) are **explicitly disallowed** under §162(c) of the IRC.

Question 3

A single taxpayer has AGI of \$90,000 and pays \$8,000 of qualified student loan interest. How much can they deduct?

- a. \$0
- b. \$2,500
- c. \$8,000
- d. \$4,000

✅ **Answer:** b. \$2,500

📘 **Explanation:** The **maximum** student-loan-interest deduction is **\$2,500**, subject to AGI phase-out.

Question 4

Which of the following items is **excludable** from gross income?

- a. Gambling winnings
- b. Interest on municipal bonds
- c. Alimony received (post-2018 divorce)
- d. Jury duty pay

✅ **Answer:** b. Interest on municipal bonds

📘 **Explanation:** Interest from **state or local government bonds** is **tax-exempt** under §103.

Question 5

A **gift tax** is imposed on:

- a. Income earned from gifts received
- b. The recipient of the gift
- c. The donor who transfers the property
- d. Both the donor and the donee

✅ **Answer:** c. The donor who transfers the property

📘 **Explanation:** Under federal law, the **donor** is generally liable for any gift tax due.

Question 6

Which of the following is **not** a requirement for an S corporation election?

- a. No more than 100 shareholders
- b. Only one class of stock
- c. All shareholders must be individuals or certain trusts
- d. At least one foreign shareholder

✅ **Answer:** d. At least one foreign shareholder

📘 **Explanation:** S corporations **cannot have foreign (non-resident alien) shareholders**.

Question 7

A taxpayer sold stock for \$20,000 that cost \$12,000 two years ago. How is the gain reported?

- a. \$8,000 short-term capital gain
- b. \$8,000 long-term capital gain
- c. \$8,000 ordinary income
- d. \$8,000 tax-exempt income

✓ **Answer:** b. \$8,000 long-term capital gain

📘 **Explanation:** Held **more than one year**, so the gain is **long-term**.

Question 8

Which of the following penalties is **most severe** under the Internal Revenue Code?

- a. Negligence penalty
- b. Failure-to-file penalty
- c. Fraud penalty
- d. Failure-to-pay penalty

✓ **Answer:** c. Fraud penalty

📘 **Explanation:** The **civil fraud penalty** can be **75 % of the underpayment**, the highest among these.

Question 9

Under the **Uniform Partnership Act**, partners share profits and losses:

- a. Equally, unless otherwise agreed
- b. In proportion to capital contributions only
- c. According to labor provided
- d. As determined by state law minimums

✓ **Answer:** a. Equally, unless otherwise agreed

📘 **Explanation:** Default rule—profits and losses are **shared equally** if no partnership agreement specifies otherwise.

Question 10

Which of the following taxpayers **must** use the accrual method for tax purposes?

- a. A self-employed consultant
- b. A small cash-basis retailer with \$20 million in receipts
- c. A C corporation with \$40 million in average annual gross receipts
- d. An individual real-estate agent

✓ **Answer:** c. A C corporation with \$40 million in average annual gross receipts

📘 **Explanation:** Corporations (other than certain small or farming entities) with **average annual gross receipts > \$30 million (as indexed)** must use the **accrual method**.

