

Advanced Tax Concept 175 Practice Test (Sample)

Study Guide



Everything you need from our exam experts!

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Questions

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- 1. How does Kristie's income from KKM Partnership during the current year total?**
 - A. \$54,000 ordinary income**
 - B. \$60,000 ordinary income**
 - C. \$33,000 ordinary income**
 - D. \$54,000 ordinary income and \$9,000 charity**
- 2. Which of the following is not a required test for the deduction of a business expense?**
 - A. Ordinary**
 - B. Necessary**
 - C. Reasonable**
 - D. Unavoidable**
- 3. What is typical for the payment received by a transferor upon the sale of a patent?**
 - A. A lump sum and/or periodic payments**
 - B. Only stock options**
 - C. Only a lump sum payment**
 - D. Only royalty payments**
- 4. How is Simpkin Corporation's apportionable income assigned to State B calculated?**
 - A. Based on sales alone.**
 - B. Using a weighted average of factors.**
 - C. Equal weights for sales and payroll only.**
 - D. Property alone determines income in State B.**
- 5. Why is Jillian's long-term capital gain taxed at 25% if she is in the higher tax bracket?**
 - A. Because it is subject to alternative tax rates.**
 - B. Because it is considered ordinary income.**
 - C. Because she cannot be subjected to lower rates.**
 - D. Because of her taxable income amount.**

- 6. When calculating the recaptured gain under § 1245, which of the following assets is not affected?**
- A. Real property.**
 - B. Depreciable property.**
 - C. Capital assets.**
 - D. Personal use property.**
- 7. How much income must Partner Donald report for the tax year based on POD Partnership distributions?**
- A. \$68,000 ordinary income.**
 - B. \$78,000 ordinary income.**
 - C. \$65,000 ordinary income; \$3,000 of long-term capital gains.**
 - D. \$75,000 ordinary income; \$3,000 of long-term capital gains.**
- 8. What is the recognized gain from the disposition of a fully depreciated barn that was destroyed by a tornado?**
- A. \$0**
 - B. \$186,000**
 - C. \$500,000**
 - D. \$543,000**
- 9. How does Belinda's basis in her LLC interests change with the LLC's liabilities?**
- A. It decreases with each liability incurred**
 - B. It increases by her share of the LLC's liabilities**
 - C. It remains constant regardless of liabilities**
 - D. It is decreased by personal guarantees**
- 10. What determines the nature of the gain or loss recognized by a taxpayer in the event of a short sale?**
- A. The fair market value of the borrowed property**
 - B. The basis of the property sold**
 - C. The transaction's nature**
 - D. All of the above**

Answers

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- 1. A**
- 2. D**
- 3. A**
- 4. B**
- 5. D**
- 6. A**
- 7. D**
- 8. B**
- 9. B**
- 10. D**

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Explanations

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1. How does Kristie's income from KKM Partnership during the current year total?

- A. \$54,000 ordinary income**
- B. \$60,000 ordinary income**
- C. \$33,000 ordinary income**
- D. \$54,000 ordinary income and \$9,000 charity**

Kristie's income from KKM Partnership totals \$54,000 in ordinary income because, in partnerships, the income is typically allocated to partners based on their share of the partnership. This allocation can stem from the partnership's earnings and is reported on the partner's individual tax returns. In this scenario, it appears that Kristie has been assigned \$54,000 from the partnership's earnings, which takes the form of ordinary income subject to standard income tax rates. This amount reflects her share of the profit from KKM Partnership, representing a straightforward allocation based on the partnership's operational results. The other options might suggest additional income types or incorrect income amounts, which would not accurately represent Kristie's total income derived from KKM Partnership for the current year. The focus here is on the ordinary income derived from the partnership, making the correct figure essential for her tax reporting and understanding of her income sources.

2. Which of the following is not a required test for the deduction of a business expense?

- A. Ordinary**
- B. Necessary**
- C. Reasonable**
- D. Unavoidable**

The deduction of a business expense must meet specific criteria to be considered valid under tax law. The tests that are required include the predicates of being "ordinary," "necessary," and "reasonable." An ordinary expense is one that is common and accepted in the taxpayer's trade or business. A necessary expense is one that is appropriate and helpful for the business, while a reasonable expense refers to the idea that the amount spent is not excessive for the services or products provided. The concept of "unavoidable," however, is not a criterion for deductibility. While business owners strive to avoid unnecessary expenses, the IRS does not require that business expenses be unavoidable for them to be deductible. This means that as long as the expenses are ordinary, necessary, and reasonable, they may still be deducted even if they could have been avoided in other ways, thus making "unavoidable" the correct choice for what is not a required test for the deduction of a business expense.

3. What is typical for the payment received by a transferor upon the sale of a patent?

A. A lump sum and/or periodic payments

B. Only stock options

C. Only a lump sum payment

D. Only royalty payments

The payment received by a transferor upon the sale of a patent is typically characterized by a lump sum and/or periodic payments. This reflects the nature of how intellectual property transactions are often structured. When a patent is sold, the parties involved may agree on an upfront lump sum payment for the rights to the patent. This provides immediate cash flow to the seller. Additionally, it is not uncommon for sellers to receive periodic payments, often structured as royalties, which are payments based on the future revenue generated from the use of the patent by the buyer. This arrangement can be advantageous for both parties: the seller receives ongoing revenue based on the patent's performance, and the buyer minimizes initial costs by potentially sharing profits instead of making a large upfront payment. This flexibility in payment options allows for a negotiated transaction that best suits the financial needs and expectations of both the transferor and the transferee.

4. How is Simpkin Corporation's apportionable income assigned to State B calculated?

A. Based on sales alone.

B. Using a weighted average of factors.

C. Equal weights for sales and payroll only.

D. Property alone determines income in State B.

The correct approach to calculate Simpkin Corporation's apportionable income assigned to State B is to use a weighted average of factors. This method generally takes into account multiple factors such as sales, property, and payroll, recognizing that each contributes to the total business activities in a state but not necessarily equally. In most states, the apportionment of income is conducted through a formula which assigns different weights to these factors based on the nature of the business and regulatory requirements. A weighted average takes into account the significance of each factor; for instance, a company might have a higher volume of sales than property or payroll, which would warrant a greater impact on the apportionment calculation. Using a weighted average ensures that the tax assignment reflects a more equitable distribution of income across states where a business operates, rather than isolating the income to one factor, which can distort the actual economic activity occurring in the state. This allows for a comprehensive assessment of how each aspect of the corporation's operations influences its overall income generation in State B.

5. Why is Jillian's long-term capital gain taxed at 25% if she is in the higher tax bracket?

- A. Because it is subject to alternative tax rates.**
- B. Because it is considered ordinary income.**
- C. Because she cannot be subjected to lower rates.**
- D. Because of her taxable income amount.**

Jillian's long-term capital gain is taxed at 25% because of her taxable income amount. In the U.S. tax system, long-term capital gains are generally taxed at preferential rates compared to ordinary income. However, these rates can vary depending on the taxpayer's income level. For individuals in higher income brackets, the maximum tax rate on long-term capital gains can be higher than the commonly discussed rates of 0% or 15%. As of the current tax guidelines, when a taxpayer's income surpasses a certain threshold, the rate on long-term capital gains can climb up to 20%, and in some specific cases, such as high-income earners subject to the Net Investment Income Tax, it can reach 25%. Thus, if Jillian's overall taxable income places her in a higher tax bracket, it would subject her long-term capital gain to the increased tax rate of 25%, reflecting the specific thresholds set by tax legislation for those gain amounts in relation to her total income. Understanding taxable income is essential to grasp why Jillian faces this specific rate on her capital gains.

6. When calculating the recaptured gain under § 1245, which of the following assets is not affected?

- A. Real property.**
- B. Depreciable property.**
- C. Capital assets.**
- D. Personal use property.**

The correct answer highlights that real property is not affected by the recapture rules under § 1245. This section primarily focuses on personal property that has been depreciated, such as machinery and equipment. When these types of assets are sold for more than their adjusted basis (accounting for depreciation), any gain up to the amount of depreciation taken is recaptured as ordinary income rather than capital gain. In contrast, real property is governed by § 1250 for recapture, which deals with the depreciation of buildings rather than land, distinguishing it from § 1245. Unlike § 1245, the recapture rules under § 1250 may apply to certain types of gain from the sale of real property, but they do not classify the gain in the same manner as with § 1245. As for the other asset types, depreciable property and personal use property are directly impacted by the recapture provisions of § 1245. Capital assets, generally subject to capital gain treatment, could also involve recapture if they were part of a personal property that has been depreciated. Thus, recognizing that real property is not subject to the rules of § 1245 provides clarity on the specific assets that are influenced by recapture gains.

7. How much income must Partner Donald report for the tax year based on POD Partnership distributions?

- A. \$68,000 ordinary income.**
- B. \$78,000 ordinary income.**
- C. \$65,000 ordinary income; \$3,000 of long-term capital gains.**
- D. \$75,000 ordinary income; \$3,000 of long-term capital gains.**

In the context of partnership distributions, a partner's taxable income is influenced by several factors, including the types of distributions they receive, the partnership's earnings, and their share of capital gains. For Partner Donald, the reporting of income consists of both ordinary income from the partnership and any long-term capital gains. The correct answer indicates that Partner Donald must report \$75,000 as ordinary income, which likely represents his share of the partnership's earnings based on a profit percentage. Additionally, he must report \$3,000 of long-term capital gains, which suggests he received distributions from the partnership that included gains from the sale of capital assets. The separation of ordinary income and capital gains is crucial for tax purposes, as they are generally taxed at different rates. Ordinary income typically includes the partner's share of income from the partnership's operations, whereas long-term capital gains are derived from assets held for more than one year and may qualify for preferential tax rates. Understanding the breakdown of this income is important for accurate tax reporting and planning. By recognizing that the total reported income includes both ordinary and capital gains, Partner Donald ensures compliance with tax regulations and accurately fulfills his tax obligations for the year.

8. What is the recognized gain from the disposition of a fully depreciated barn that was destroyed by a tornado?

- A. \$0**
- B. \$186,000**
- C. \$500,000**
- D. \$543,000**

In the case of a fully depreciated barn that has been destroyed, it's important to understand how recognized gain is calculated, particularly when it comes to destroyed or involuntarily converted property. When an asset is fully depreciated, it means that the depreciation taken on it has reduced its book value to zero. If this asset is destroyed, the owner may receive insurance proceeds as compensation for the loss. In this scenario, the recognized gain from the disposition of the barn would be directly linked to these insurance proceeds. If the insurance payment for the destroyed barn was \$186,000, this amount represents the gain realized. Since the barn had a basis of \$0 after full depreciation, any amount received in the form of insurance proceeds is considered a gain. Therefore, the individual recognizes a gain equal to the insurance payout, which in this case is \$186,000. This amount is fully taxable because it exceeds the basis, which is zero. In summary, the recognized gain from the disposition of the fully depreciated barn is correctly identified as \$186,000, reflecting the fact that when asset value is compensated through insurance due to destruction, that compensation is treated as realized gain if the asset was fully depreciated to zero.

9. How does Belinda's basis in her LLC interests change with the LLC's liabilities?

- A. It decreases with each liability incurred**
- B. It increases by her share of the LLC's liabilities**
- C. It remains constant regardless of liabilities**
- D. It is decreased by personal guarantees**

Belinda's basis in her LLC interests increases by her share of the LLC's liabilities due to how tax law treats the basis in partnership and LLC interests. In general, a member's basis in an LLC reflects their investment and share of the liabilities of the entity. When an LLC incurs debt, the members typically increase their basis in the LLC by their proportionate share of that debt, as it represents an economic obligation that members are ultimately responsible for. This increase is significant for tax purposes because it allows members to deduct losses and access the basis against distributions from the LLC. Therefore, as the LLC takes on more liabilities, each member's ability to utilize their basis effectively increases, fostering both a clear understanding of individual investment and risk exposure within the entity.

10. What determines the nature of the gain or loss recognized by a taxpayer in the event of a short sale?

- A. The fair market value of the borrowed property**
- B. The basis of the property sold**
- C. The transaction's nature**
- D. All of the above**

In the context of a short sale, the nature of the gain or loss recognized by a taxpayer is influenced by multiple factors, which collectively contribute to the overall determination of the tax implications. The fair market value of the borrowed property is critical because it helps ascertain the market conditions at the time the sale occurs. This valuation is fundamental in determining how much the taxpayer will receive versus what is owed, impacting whether a gain or loss is realized. Additionally, the basis of the property sold plays a significant role. This basis represents the original value of the asset, adjusted for any improvements or depreciation, and is subtracted from the sale proceeds to determine the gain or loss. An accurate basis measurement is essential to calculate the correct taxable gain or loss the taxpayer must report. Finally, the transaction's nature encompasses the specifics surrounding the short sale itself. The IRS has particular rules governing how short sales are treated, and understanding whether the transaction is classified as a capital gain or ordinary income can significantly affect tax outcomes. Thus, the interaction of these elements—fair market value, property basis, and the nature of the transaction—determines how the gain or loss from a short sale is recognized for tax purposes. This comprehensive approach ensures that all aspects influencing the tax outcome