

# Full-Length Practice Test 6

**Instructions:** This practice test contains 300 multiple-choice questions divided into three parts. Select the best answer for each question

## Part 1: Individual

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1. Tax returns for calendar year taxpayers are generally due by:
  - A. April 15
  - B. March 15
  - C. June 15
  - D. May 15
  
2. Automatic extension for individual returns provides additional time of:
  - A. 3 months
  - B. 4 months
  - C. 6 months
  - D. 9 months
  
3. Extension of time to file does NOT extend time to:
  - A. Gather documents
  - B. Consult advisor
  - C. Prepare return
  - D. Pay tax owed
  
4. Returns filed on April 1 when due date is April 15 are considered filed on:
  - A. April 1
  - B. April 15
  - C. Filing date
  - D. Due date
  
5. Combat zone extensions can extend filing deadlines for:
  - A. 90 days
  - B. 6 months
  - C. 1 year
  - D. 180 days plus service time
  
6. Fiscal year taxpayers must file returns by:
  - A. 15th day of 4th month after year-end

- B. March 15
  - C. April 15
  - D. Last day of year
7. Taxpayers abroad receive automatic extension to file until:
- A. April 15
  - B. May 15
  - C. June 15
  - D. August 15
8. Form 4868 must be filed by the original due date to obtain:
- A. Penalty waiver
  - B. Extension to file
  - C. Extension to pay
  - D. Interest waiver
9. Reasonable cause for late filing can include:
- A. Preparer error if reasonable reliance shown
  - B. Lack of funds
  - C. Forgetfulness
  - D. Busy schedule
10. Amended returns are filed on Form:
- A. 1040-X
  - B. 1040-SR
  - C. 1040-EZ
  - D. 1040-A
11. Amended returns must generally be filed within:
- A. 1 year
  - B. 2 years
  - C. 3 years
  - D. 5 years
12. Taxpayers can claim refunds on amended returns if filed within the later of 3 years from filing or:
- A. 1 year from payment
  - B. 2 years from payment
  - C. 3 years from payment
  - D. 4 years from payment

13. Form 1040-X must be signed by:
- A. Taxpayer
  - B. Preparer only
  - C. Spouse if joint return
  - D. IRS agent
14. Injured spouse relief helps recover refund offset for spouse's:
- A. Medical bills
  - B. Credit card debt
  - C. Personal loans
  - D. Pre-marriage debt
15. Innocent spouse relief requires request within:
- A. 1 year
  - B. 2 years from collection
  - C. 2 years of notice
  - D. 3 years
16. Equitable relief considers whether spouses were:
- A. Married
  - B. Separated or divorced
  - C. Living together
  - D. Employed
17. Relief from joint liability can be requested on Form:
- A. 8379
  - B. 8857
  - C. 8332
  - D. 8857
18. Offer in compromise based on doubt as to liability questions whether:
- A. Tax is legally owed
  - B. Taxpayer can pay
  - C. Amount is correct
  - D. Return was filed
19. Installment agreements allow payment over time with:
- A. No interest
  - B. No penalties

- C. Interest and penalties
- D. Reduced rates

20. Currently not collectible status applies when collection would cause:

- A. Inconvenience
- B. Hardship
- C. Delay
- D. Expense

21. Social Security benefits become taxable when provisional income exceeds threshold of:

- A. \$25,000 for single
- B. \$32,000 for single
- C. \$44,000 for single
- D. \$50,000 for single

22. Provisional income includes AGI plus tax-exempt interest plus:

- A. All Social Security
- B. Capital gains
- C. Itemized deductions
- D. Half of Social Security

23. Maximum taxable portion of Social Security benefits is:

- A. 50%
- B. 85%
- C. 75%
- D. 100%

24. Tier 1 railroad retirement benefits are taxed like:

- A. Wages
- B. Pension
- C. Social Security
- D. Annuity

25. Disability income from employer-paid policy is:

- A. Tax-free
- B. Partially taxable
- C. Deductible
- D. Fully taxable

26. Workers compensation benefits are generally:

- A. Tax-exempt
- B. Taxable
- C. Partially taxable
- D. Deductible

27. Unemployment compensation is:

- A. Tax-free
- B. Fully taxable
- C. Partially taxable
- D. Deductible

28. Severance pay received upon termination is:

- A. Tax-free
- B. Capital gain
- C. Ordinary income
- D. Deferred

29. Strike benefits from union are:

- A. Taxable
- B. Tax-free
- C. Deductible
- D. Deferred

30. Punitive damages from lawsuit are:

- A. Tax-free
- B. Partially taxable
- C. Capital gain
- D. Fully taxable

31. Compensatory damages for physical injury are:

- A. Taxable
- B. Partially taxable
- C. Tax-exempt
- D. Deferred

32. Emotional distress damages not related to physical injury are:

- A. Tax-free
- B. Taxable
- C. Partially taxable
- D. Deductible

33. Attorney fees in employment discrimination case can be deducted:

- A. Schedule A
- B. Schedule C
- C. Not deductible
- D. Above-the-line

34. Alaska Permanent Fund dividends are:

- A. Taxable
- B. Tax-exempt
- C. Partially taxable
- D. Deferred

35. State tax refunds are taxable if taxpayer:

- A. Filed extension
- B. Paid estimated taxes
- C. Itemized in prior year
- D. Took standard deduction

36. Gambling winnings are reported on:

- A. Schedule A
- B. Form 1040
- C. Schedule C
- D. Form W-2G only

37. Gambling losses are deductible up to:

- A. Gambling winnings
- B. \$3,000
- C. 50% of winnings
- D. AGI

38. Professional gamblers report income on:

- A. Form 1040
- B. Schedule A
- C. Form W-2G
- D. Schedule C

39. Hobby income is reported on:

- A. Schedule A
- B. Schedule C

- C. Form 1040
- D. Not reported

40. Hobby expenses after TCJA are:

- A. Deductible Schedule A
- B. Not deductible
- C. Deductible Schedule C
- D. 50% deductible

41. Jury duty pay is:

- A. Tax-exempt
- B. Partially taxable
- C. Deductible
- D. Fully taxable

42. Election worker pay is:

- A. Tax-exempt up to \$2,000
- B. Fully taxable
- C. Tax-exempt
- D. Deferred

43. Notary public fees are:

- A. Tax-exempt
- B. Partially taxable
- C. Fully taxable
- D. Deferred

44. Tips must be reported to employer if they exceed:

- A. \$10 per month
- B. \$20 per month
- C. \$50 per month
- D. \$100 per month

45. Allocated tips shown on Form W-2 are:

- A. Already included in wages
- B. Not included in wages
- C. Tax-exempt
- D. Deferred

46. Credit for excess Social Security withheld by multiple employers is claimed on:

- A. Schedule 1
- B. Schedule 2
- C. Form 8959
- D. Schedule 3

47. Medicare surtax applies to wages exceeding:

- A. \$150,000 single
- B. \$250,000 MFJ
- C. \$200,000 single
- D. \$300,000 MFJ

48. Self-employment tax is calculated on Schedule:

- A. C
- B. SE
- C. 1
- D. F

49. Ministers can elect out of self-employment tax for:

- A. All income
- B. Wages only
- C. Housing only
- D. Ministerial services

50. Notch year for Social Security refers to persons born between:

- A. 1917–1921
- B. 1940–1960
- C. 1950–1970
- D. 1960–1980

51. Lump sum Social Security benefits can be taxed using:

- A. Averaging
- B. Prior year election
- C. Lump sum election
- D. Deferred

52. Repayment of Social Security benefits over \$3,000 creates:

- A. Deduction
- B. Credit or deduction choice
- C. Credit only
- D. No benefit

53. Tier 2 railroad retirement is taxed as:
- A. Pension
  - B. Wages
  - C. Social Security
  - D. Annuity
54. Disability pensions before minimum retirement age are taxed as:
- A. Pension
  - B. Annuity
  - C. Social Security
  - D. Wages
55. Simplified method for pension taxation uses:
- A. Life expectancy
  - B. Age-based table
  - C. Contribution ratio
  - D. IRS formula
56. General rule for annuities uses:
- A. Simplified method
  - B. Life expectancy tables
  - C. Exclusion ratio
  - D. Age-based tables
57. Inherited IRA distributions by non-spouse beneficiary must be completed within:
- A. 5 years
  - B. Beneficiary's lifetime
  - C. 20 years
  - D. 10 years
58. Designated Roth accounts in 401(k) plans have qualified distributions after:
- A. 5 years and age 59½
  - B. Age 59½ only
  - C. 5 years only
  - D. Age 70½
59. In-plan Roth rollovers create:
- A. Tax-free conversion
  - B. Taxable income

- C. Penalty
- D. Deferred income

60. 72(t) payments must continue for greater of 5 years or age:

- A. 55
- B. 65
- C. 59½
- D. 62

61. Qualified charitable distributions count toward:

- A. RMD
- B. Contribution limit
- C. Deduction
- D. Credit

62. Beneficiary IRA for spouse can be treated as:

- A. Taxable distribution
- B. Gift
- C. Rollover
- D. Own IRA

63. Roth IRA conversions are taxable in year of:

- A. Distribution
- B. Conversion
- C. Re-conversion
- D. Withdrawal

64. Saver's credit percentages are 50%, 20%, and:

- A. 5%
- B. 15%
- C. 10%
- D. 25%

65. Retirement plan loans exceeding limits are treated as:

- A. Taxable distribution
- B. Tax-free
- C. Deferred
- D. Penalty-free

66. Qualified disaster retirement distributions can be repaid within:

- A. 1 year
- B. 2 years
- C. 5 years
- D. 3 years

67. Coronavirus-related distributions were available for withdrawals up to:

- A. \$50,000
- B. \$75,000
- C. \$100,000
- D. \$150,000

68. Hardship distributions from 401(k) are:

- A. Tax-free
- B. Taxable but penalty-free
- C. Tax and penalty-free
- D. Loans

69. Substantially equal periodic payments can use:

- A. Any method
- B. Fixed payment only
- C. RMD method only
- D. IRS-approved methods

70. Qualified reservist distributions are penalty-free if called to duty for:

- A. 180 days or more
- B. 90 days
- C. 60 days
- D. Any period

71. Basis in traditional IRA is tracked on Form:

- A. 5498
- B. 1099-R
- C. 8606
- D. 1040

72. Excess Roth IRA contributions are subject to excise tax of:

- A. 10%
- B. 6%
- C. 25%
- D. 50%

73. Qualified education expenses for IRA penalty exception include:
- A. Room and board
  - B. Tuition only
  - C. Books only
  - D. Tuition, fees, books, supplies
74. First-time homebuyer exception applies if no home owned in prior:
- A. 2 years
  - B. 5 years
  - C. 1 year
  - D. 3 years
75. Health insurance premiums during unemployment can be IRA penalty exception if unemployed for:
- A. 6 weeks
  - B. 8 weeks
  - C. 12 weeks
  - D. 26 weeks
76. Qualified birth or adoption distribution limit is:
- A. \$10,000
  - B. \$5,000
  - C. \$7,500
  - D. \$15,000
77. Tax on early IRA distributions is:
- A. 10%
  - B. 6%
  - C. 25%
  - D. 50%
78. SIMPLE IRA early withdrawal tax in first 2 years is:
- A. 10%
  - B. 6%
  - C. 50%
  - D. 25%
79. Roth IRA ordering rules for distributions: contributions first, then conversions, then:
- A. Penalties

- B. Taxes
- C. Earnings
- D. Basis

80. Five-year rule for Roth conversions applies separately to:

- A. All conversions combined
- B. Each conversion
- C. First conversion only
- D. None

81. Qualified education loan interest deduction phase-out for MFJ begins at:

- A. \$150,000
- B. \$185,000
- C. \$200,000
- D. \$165,000

82. Private student loan interest is deductible if:

- A. Qualified education loan
- B. Not deductible
- C. From bank only
- D. Subsidized

83. Student loan interest paid by parent for dependent student is deductible by:

- A. Neither
- B. Student
- C. Parent
- D. Both

84. Qualified tuition programs (529) can be rolled to Roth IRA starting in:

- A. 2023
- B. 2024
- C. 2025
- D. 2026

85. ABLE account contribution limit equals:

- A. Gift tax exclusion
- B. IRA limit
- C. \$10,000
- D. \$5,000

86. Coverdell ESA contributions must be made by:
- A. Year-end
  - B. April 15
  - C. Tax return due date
  - D. Filing deadline
87. Qualified tuition programs can be used for K–12 tuition up to:
- A. \$5,000 per year
  - B. \$15,000 per year
  - C. \$10,000 per year
  - D. Unlimited
88. Education credits cannot be claimed if:
- A. Filing jointly
  - B. Married filing separately
  - C. Head of household
  - D. Single
89. American Opportunity Credit is 100% of first \$2,000 plus 25% of next:
- A. \$1,000
  - B. \$2,000
  - C. \$3,000
  - D. \$2,000
90. Lifetime Learning Credit rate is:
- A. 20%
  - B. 25%
  - C. 30%
  - D. 50%
91. Qualified education expenses do not include:
- A. Books
  - B. Tuition
  - C. Room and board
  - D. Fees
92. Education credits reduce tax while tuition deduction reduces:
- A. Credits
  - B. Income
  - C. Deductions

D. AGI

93. Hope Scholarship Credit was replaced by:

- A. American Opportunity Credit
- B. Lifetime Learning Credit
- C. Education deduction
- D. Saver's Credit

94. Form 1098-T is provided by:

- A. Employer
- B. Bank
- C. Lender
- D. Educational institution

95. Student activity fees are qualified education expenses if:

- A. Optional
- B. Required for enrollment
- C. For sports
- D. Refundable

96. Education tax benefits cannot be claimed for same expenses paid with:

- A. Loans
- B. Savings
- C. Tax-free scholarships
- D. Parent contributions

97. Qualified education expenses can be paid with:

- A. Cash only
- B. Credit card
- C. Scholarship
- D. Loans paid with student funds

98. Employer educational assistance excludes up to \$5,250 for:

- A. Graduate or undergraduate
- B. Undergraduate only
- C. Job-related only
- D. Degree programs only

99. Working condition fringe benefit for education requires:

- A. Any course

- B. Personal interest
- C. Job-related
- D. Degree program

100. Scholarship income for degree candidates is tax-free if used for:
- A. Any expense
  - B. Tuition and required fees
  - C. Room and board
  - D. Personal expenses

## Part 2: Businesses

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1. Accrual method taxpayers recognize income when:
  - A. Cash received
  - B. Earned
  - C. Invoiced
  - D. Deposited
  
2. Cash method businesses recognize expenses when:
  - A. Incurred
  - B. Invoiced
  - C. Accrued
  - D. Paid
  
3. Economic performance for services received occurs when:
  - A. Services provided
  - B. Contracted
  - C. Invoiced
  - D. Agreed
  
4. Prepaid expenses under 12-month rule are deductible if benefit doesn't extend beyond:
  - A. Tax year-end
  - B. Filing date
  - C. 12 months or tax year-end of following year
  - D. Payment date
  
5. All events test requires liability to be fixed, amount determinable, and:
  - A. Invoiced
  - B. Economic performance
  - C. Paid

- D. Approved
6. Inventory methods must be consistently applied and require:
    - A. IRS approval to change
    - B. Annual election
    - C. Cash method
    - D. Accrual method
  7. LIFO reserve increases are:
    - A. Income
    - B. Deduction
    - C. Not recognized
    - D. Taxable
  8. LIFO conformity rule requires LIFO for tax if used for:
    - A. Internal reports
    - B. Management reports
    - C. Financial statements
    - D. Investors
  9. Average cost method for inventory calculates cost as:
    - A. Weighted average
    - B. Simple average
    - C. LIFO
    - D. FIFO
  10. Inventory write-downs to market value are deductible when:
    - A. Anticipated
    - B. Occurs
    - C. Planned
    - D. Estimated
  11. Bad debt deduction for business requires debt to be:
    - A. Written off
    - B. Uncollectible
    - C. Late
    - D. Worthless
  12. Specific charge-off method requires identifying:
    - A. Total bad debts

- B. Estimated losses
  - C. Specific debt
  - D. Average losses
13. Reserve method for bad debts was eliminated except for certain:
- A. Large businesses
  - B. Small banks
  - C. Corporations
  - D. Partnerships
14. Related party bad debts between family members are treated as:
- A. Business bad debts
  - B. Gifts
  - C. Loans
  - D. Nonbusiness bad debts
15. Business bad debts are deductible as:
- A. Capital loss
  - B. Itemized deduction
  - C. Ordinary loss
  - D. Schedule A
16. Nonbusiness bad debts are treated as:
- A. Ordinary loss
  - B. Schedule A deduction
  - C. Not deductible
  - D. Short-term capital loss
17. Guarantor payments on defaulted business loans are:
- A. Business bad debt
  - B. Gifts
  - C. Not deductible
  - D. Capital loss
18. Worthless securities are treated as loss on:
- A. Discovery date
  - B. Last day of tax year
  - C. Filing date
  - D. Sale date

19. Section 1244 small business stock ordinary loss limit for MFJ is:
- A. \$50,000
  - B. \$75,000
  - C. \$100,000
  - D. \$200,000
20. Domestic production activities deduction was eliminated for years after:
- A. 2016
  - B. 2018
  - C. 2019
  - D. 2017
21. Qualified business income deduction is:
- A. 10%
  - B. 20%
  - C. 25%
  - D. 15%
22. QBI deduction phases out for specified service businesses when taxable income exceeds:
- A. \$150,000
  - B. \$200,000
  - C. \$191,950 single
  - D. \$250,000
23. W-2 wage limitation for QBI applies when taxable income exceeds:
- A. \$191,950 single
  - B. \$150,000
  - C. \$200,000
  - D. \$100,000
24. QBI deduction is limited to 50% of W-2 wages or 25% of wages plus:
- A. Capital
  - B. Assets
  - C. Income
  - D. 2.5% of property
25. Specified service businesses include health, law, accounting, and:
- A. Engineering
  - B. Real estate
  - C. Consulting

D. Architecture

26. QBI deduction is taken:

- A. Schedule C
- B. Below-the-line
- C. Above-the-line
- D. After AGI

27. Aggregation of businesses for QBI requires common ownership of:

- A. 25%
- B. 50%
- C. 75%
- D. 50% or more

28. Qualified property for QBI means depreciable property with period not ended before close of year and used in production of:

- A. QBI
- B. Income
- C. Revenue
- D. Gains

29. QBI does not include:

- A. Partnership income
- B. Reasonable compensation
- C. S corporation income
- D. Sole proprietor income

30. REIT dividends qualify for QBI deduction of up to:

- A. 10%
- B. 15%
- C. 20%
- D. 25%

31. Publicly traded partnership income qualifies for QBI deduction up to:

- A. 10%
- B. 15%
- C. 25%
- D. 20%

32. QBI deduction cannot exceed:

- A. 20% of taxable income
- B. 25% of income
- C. W-2 wages
- D. Net income

33. Patronized cooperatives provide QBI deduction on:

- A. All income
- B. Patronage dividends
- C. Qualified payments
- D. Distributions

34. Agricultural cooperatives Section 199A deduction is:

- A. 10%
- B. 9%
- C. 15%
- D. 20%

35. Rental real estate can be trade or business for QBI if:

- A. Any rental
- B. Passive
- C. 250+ hours and records
- D. Investment

36. Safe harbor for rental real estate QBI requires:

- A. 100 hours
- B. 200 hours
- C. 500 hours
- D. 250 hours

37. Triple net leases generally don't qualify as:

- A. Rental
- B. Passive
- C. Trade or business
- D. Investment

38. QBI loss carryforward offsets QBI in future years as:

- A. Carryforward loss
- B. Current loss
- C. Deduction
- D. Credit

39. Unadjusted basis of qualified property is determined:
- A. At acquisition
  - B. After depreciation
  - C. Fair market value
  - D. Original cost
40. Short tax years for QBI deduction require:
- A. Annualization
  - B. Proration
  - C. Full deduction
  - D. No deduction
41. Trusts and estates can claim QBI deduction with:
- A. No limitation
  - B. Same limitations as individuals
  - C. Different rules
  - D. Not eligible
42. QBI from Puerto Rico sources is:
- A. Excluded
  - B. Included
  - C. Partially included
  - D. Deferred
43. Excess business loss limitation for 2024 is approximately:
- A. \$250,000 single
  - B. \$305,000 single
  - C. \$500,000 MFJ
  - D. \$610,000 MFJ
44. Excess business losses are treated as:
- A. Lost
  - B. Current deduction
  - C. Capital loss
  - D. NOL carryforward
45. Excess business loss applies after application of:
- A. Standard deduction
  - B. At-risk and passive loss rules

- C. QBI deduction
- D. Itemized deductions

46. Partner's distributive share is determined by:

- A. Partnership agreement
- B. Capital account
- C. Ownership percentage
- D. Services provided

47. Guaranteed payments are deductible by partnership and taxable to partner as:

- A. Capital gain
- B. Return of capital
- C. Not taxable
- D. Ordinary income

48. Partnership basis increases include income and:

- A. Distributions
- B. Liabilities
- C. Deductions
- D. Withdrawals

49. Partnership distributions reduce basis and are taxable if exceeding:

- A. Income
- B. Capital
- C. Basis
- D. Liabilities

50. Liquidating distributions are taxable to extent exceeding:

- A. Basis
- B. FMV
- C. Capital account
- D. Income

51. Hot assets include unrealized receivables and:

- A. Cash
- B. Capital assets
- C. Real estate
- D. Inventory

52. Section 751 property creates ordinary income on:

- A. All sales
- B. Distributions and sales
- C. Contributions
- D. Liquidations

53. Partnership interest purchased has inside basis equal to:

- A. Purchase price
- B. Partner's capital account
- C. FMV of assets
- D. Tax basis of assets

54. Section 754 election adjusts inside basis to equal:

- A. FMV
- B. Book value
- C. Outside basis
- D. Capital account

55. Section 743(b) adjustment applies to:

- A. All partners
- B. Contributing partner
- C. Selling partner
- D. Transferee partner

56. Partnership self-employment income includes distributive share for:

- A. All partners
- B. General partners
- C. Limited partners
- D. Managing partners

57. Guaranteed payments for services are subject to:

- A. Capital gains tax
- B. Not taxed
- C. Self-employment tax
- D. Withholding

58. Family partnerships require capital to be:

- A. Material income-producing factor
- B. Gifted
- C. Inherited
- D. Loaned

59. Partnership minimum gain prevents distribution exceeding partner's:
- A. Capital
  - B. Income
  - C. Share of minimum gain
  - D. Basis
60. LLC default classification for multi-member is:
- A. Corporation
  - B. Partnership
  - C. Disregarded entity
  - D. Trust
61. Single-member LLC default classification is:
- A. Disregarded entity
  - B. Partnership
  - C. Corporation
  - D. Trust
62. Check-the-box election allows LLC to elect treatment as:
- A. Trust
  - B. Estate
  - C. Corporation
  - D. Individual
63. S corporation election requires shareholders to be:
- A. Any entity
  - B. Corporations
  - C. Partnerships
  - D. Individuals, estates, certain trusts
64. S corporation can have maximum of:
- A. 75 shareholders
  - B. 100 shareholders
  - C. 50 shareholders
  - D. Unlimited
65. S corporation stock ownership by nonresident alien is:
- A. Permitted
  - B. Limited

- C. Not permitted
- D. Allowed with election

66. S corporation must use:

- A. Calendar year
- B. Any tax year
- C. Fiscal year
- D. Required year or Section 444

67. S corporation built-in gains tax recognition period is:

- A. 3 years
- B. 5 years
- C. 10 years
- D. 7 years

68. S corporation AAA represents:

- A. Taxable income
- B. E&P
- C. Retained earnings
- D. Accumulated adjustments

69. S corporation distributions come first from:

- A. AAA
- B. Earnings and profits
- C. Basis
- D. Capital

70. S corporation shareholder basis includes:

- A. All liabilities
- B. Entity liabilities
- C. Direct loans only
- D. Guaranteed debt

71. QSub election allows S corporation to own:

- A. Any subsidiary
- B. C corporation
- C. Partnership
- D. 100% of another corporation

72. Post-termination transition period for S corporation is:

- A. 6 months
- B. 1 year
- C. 2 years
- D. 180 days

73. S corporation cannot have more than one class of stock, but differences in:

- A. Dividends allowed
- B. Liquidation rights
- C. Ownership percentages
- D. Voting rights permitted

74. S election is made on Form:

- A. 2553
- B. 1120-S
- C. 8832
- D. 1065

75. C corporation tax rate is:

- A. Graduated
- B. 25%
- C. 35%
- D. 21%

76. Dividends received deduction for 20% or more ownership is:

- A. 50%
- B. 65%
- C. 80%
- D. 100%

77. DRD for ownership under 20% is:

- A. 100%
- B. 65%
- C. 50%
- D. 70%

78. Corporate capital losses can offset:

- A. Capital gains only
- B. Ordinary income
- C. Any income
- D. Operating income

79. Corporate capital loss carryback is:
- A. 2 years
  - B. None
  - C. 5 years
  - D. 3 years
80. Corporate charitable contribution limit is:
- A. 60%
  - B. 10%
  - C. 25%
  - D. 50%
81. Accumulated earnings tax applies at rate of:
- A. 20%
  - B. 21%
  - C. 15%
  - D. 25%
82. Reasonable accumulation for business needs avoids:
- A. Dividend tax
  - B. AMT
  - C. Accumulated earnings tax
  - D. NOL limitation
83. Personal holding company tax applies when PHC income exceeds:
- A. 50%
  - B. 75%
  - C. 25%
  - D. 60%
84. Schedule M-1 reconciles book income to:
- A. Cash flow
  - B. Taxable income
  - C. Financial statement income
  - D. EBITDA
85. Schedule M-3 is required for corporations with assets exceeding:
- A. \$1 million
  - B. \$5 million

- C. \$10 million
- D. \$50 million

86. Organizational costs can be deducted up to \$5,000 if total costs don't exceed:

- A. \$50,000
- B. \$55,000
- C. \$100,000
- D. \$25,000

87. Excess organizational costs are amortized over:

- A. 60 months
- B. 120 months
- C. 84 months
- D. 180 months

88. Related party losses between corporation and shareholder owning over 50% are:

- A. Fully deductible
- B. Disallowed
- C. Deferred
- D. Limited

89. Constructive ownership rules attribute stock from:

- A. Spouse and children
- B. Business partners
- C. Cousins
- D. Friends

90. Controlled group rules prevent multiple corporations from claiming:

- A. Losses
- B. Credits
- C. Multiple tax benefits
- D. Deductions

91. Brother-sister controlled group requires common ownership of more than:

- A. 25%
- B. 75%
- C. 100%
- D. 50%

92. Parent-subsidiary group requires ownership of:

- A. 50%
- B. 80% or more
- C. 100%
- D. 75%

93. Affiliated groups can file:

- A. Separate returns
- B. Combined returns
- C. Consolidated returns
- D. Joint returns

94. Consolidated return regulations are issued under Code Section:

- A. 1502
- B. 1501
- C. 1504
- D. 1503

95. Intercompany transactions in consolidated group are:

- A. Eliminated
- B. Recognized immediately
- C. Taxable
- D. Deferred

96. NOL in consolidated group can offset income of:

- A. Parent only
- B. Subsidiaries
- C. Group members
- D. Outside entities

97. Regular tax credit for prior year AMT is:

- A. Nonrefundable
- B. Refundable
- C. Carried forward
- D. Lost

98. Minimum tax credit carryforward is:

- A. 20 years
- B. 10 years
- C. Indefinite
- D. 5 years

99. Research credit is part of general business credit with carryback of:
- A. None
  - B. 2 years
  - C. 3 years
  - D. 1 year
100. Work opportunity credit must be certified by:
- A. IRS
  - B. State workforce agency
  - C. Employer
  - D. Employee

### **Part 3: Representation, Practices, And Procedures**

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1. Circular 230 is found in Title 31 of:
  - A. IRC
  - B. Treasury Regulations
  - C. Code of Federal Regulations
  - D. United States Code
  
2. Enrolled agents are enrolled to practice before:
  - A. IRS
  - B. Tax Court
  - C. All federal agencies
  - D. State tax agencies
  
3. Attorneys must be licensed and in good standing in:
  - A. Any state
  - B. State of practice
  - C. Federal court
  - D. Any U.S. jurisdiction
  
4. CPAs must hold valid license from:
  - A. AICPA
  - B. State board
  - C. IRS
  - D. SEC
  
5. Enrolled actuaries can represent clients on matters related to:

- A. All tax matters
  - B. Actuarial matters
  - C. Pension plans
  - D. Insurance
6. Registered tax return preparers program was:
- A. Eliminated
  - B. Expanded
  - C. Made mandatory
  - D. Continued
7. Circular 230 sanctions include censure, suspension, and:
- A. Fine
  - B. Imprisonment
  - C. License revocation
  - D. Disbarment
8. OPR stands for Office of:
- A. Practitioner Responsibility
  - B. Public Relations
  - C. Professional Responsibility
  - D. Procedural Review
9. Practitioner must promptly advise client of:
- A. All IRS notices
  - B. Noncompliance or errors
  - C. Tax law changes
  - D. Filing deadlines
10. Confidential client information can be disclosed:
- A. With client consent
  - B. Never
  - C. To other preparers
  - D. To IRS
11. Conflicts of interest require:
- A. Declining representation
  - B. IRS notification
  - C. Court approval
  - D. Informed consent

12. Return of client records must occur:
- A. After 3 years
  - B. When requested
  - C. After payment
  - D. At practitioner's discretion
13. Contingent fees are prohibited except for:
- A. Original returns
  - B. Examination or refund claims
  - C. All services
  - D. Opinions
14. Standards for tax returns require practitioner to have:
- A. Substantial authority
  - B. Reasonable basis
  - C. Any position
  - D. More likely than not
15. Written advice standards require consideration of:
- A. Client goals
  - B. Relevant facts
  - C. Tax savings
  - D. Refund amount
16. Covered opinions require compliance with Section:
- A. 10.35
  - B. 10.36
  - C. 10.37
  - D. 10.33
17. Tax shelter opinion must include discussion of:
- A. Tax benefits
  - B. All significant issues
  - C. Fees
  - D. Savings amount
18. Practitioner may not represent conflicting interests without:
- A. IRS approval
  - B. Waiver

- C. Court order
- D. Written consent

19. Fee information must be furnished in writing if requested before:

- A. Engagement
- B. Filing
- C. Payment
- D. Conclusion

20. Practitioner cannot charge unconscionable fees or:

- A. Hourly rates
- B. Flat fees
- C. Value billing
- D. Charge clearly excessive

21. Solicitation cannot be false or misleading or use:

- A. Advertising
- B. Coercion
- C. Marketing
- D. Referrals

22. Best practices include communicating clearly and establishing:

- A. High fees
- B. Facts and circumstances
- C. Quick service
- D. Guarantees

23. Practitioner lacking competence must:

- A. Decline engagement
- B. Consult or study
- C. Refer out
- D. Withdraw

24. Knowledge of client omission requires advising client and:

- A. Notifying IRS
- B. Consequences of noncompliance
- C. Filing amended return
- D. Withdrawing

25. Diligence as to accuracy requires reasonable inquiry when information appears:

- A. Low
- B. Incorrect
- C. Normal
- D. High

26. Reliance on client information is permitted absent reason to believe information is:

- A. Estimated
- B. Approximate
- C. Rounded
- D. Incorrect

27. Practitioner must sign return if responsible for:

- A. Any position
- B. Filing
- C. Preparation
- D. Substantive accuracy

28. Negotiation of refund check requires:

- A. Specific written authorization
- B. Power of attorney
- C. Any authorization
- D. Verbal consent

29. Practitioner knowing of client intent to not comply must:

- A. Report to IRS
- B. Withdraw
- C. Continue
- D. Notify authorities

30. Advertising must be truthful and cannot make unverifiable claims about:

- A. Services
- B. Location
- C. Quality
- D. Credentials

31. Name and designation must be shown correctly and cannot be:

- A. Abbreviated
- B. Shortened
- C. Misleading
- D. Professional

32. Former government employee cannot represent on matter in which personally and substantially participated as:
- A. Witness
  - B. Employee
  - C. Government employee
  - D. Advisor
33. Practice before IRS includes:
- A. Correspondence
  - B. All communications
  - C. Representation
  - D. Phone calls
34. Limited practice allows unenrolled preparer to represent only on returns they:
- A. Signed
  - B. Prepared and signed
  - C. Filed
  - D. Reviewed
35. Power of attorney must include:
- A. Signature
  - B. Notarization
  - C. Witness
  - D. All matters
36. Form 2848 authorizes representative to:
- A. Receive information
  - B. Sign returns
  - C. Represent and receive information
  - D. Perform acts
37. Form 8821 allows disclosure of information but not:
- A. Examination
  - B. Collection
  - C. Representation
  - D. Correspondence
38. CAF number is assigned to:
- A. Taxpayer

- B. Representative
- C. Both
- D. IRS

39. Centralized Authorization File retains Forms 2848 for:

- A. 1 year
- B. 2 years
- C. 3 years
- D. Permanently

40. Power of attorney can specify limited matters or:

- A. General authority
- B. Specific years
- C. All years
- D. Current year

41. Multiple representatives can be appointed with:

- A. One acting
- B. All acting jointly
- C. Either acting
- D. Sequential authority

42. Revocation of power of attorney requires:

- A. New Form 2848
- B. Written notice
- C. IRS approval
- D. Court order

43. Declaration of representative requires practitioner to state they are:

- A. Qualified
- B. Authorized and eligible
- C. Licensed
- D. Certified

44. Unenrolled return preparer can appear before:

- A. Appeals
- B. Tax Court
- C. Customer service and revenue agents
- D. Revenue officers

45. Annual Filing Season Program provides limited representation for those completing:
- A. 18 hours CE
  - B. 72 hours CE
  - C. 15 hours CE
  - D. EA exam
46. Enrolled agent continuing education requires 72 hours every:
- A. Year
  - B. 2 years
  - C. 3 years
  - D. 5 years
47. Ethics CE requirement for EAs is 2 hours per year or:
- A. 4 hours per enrollment cycle
  - B. 6 hours per cycle
  - C. None
  - D. 8 hours
48. CE carryforward is permitted for hours exceeding annual requirement up to:
- A. Unlimited
  - B. 12 hours
  - C. 24 hours
  - D. No carryforward
49. Enrolled agent enrollment cycle is:
- A. Annual
  - B. Every 2 years
  - C. Every 3 years
  - D. Every 5 years
50. Failure to meet CE requirements results in:
- A. Fine
  - B. Suspension
  - C. Ineligibility for renewal
  - D. Probation
51. Enrollment renewal requires filing Form:
- A. 8554
  - B. 23
  - C. 2848

D. 8821

52. EA exam passing requires score of approximately:

- A. 70%
- B. 65%
- C. 80%
- D. 75%

53. Special enrollment examination covers three parts tested over:

- A. 1 day
- B. 2 days
- C. Separately scheduled
- D. 3 consecutive days

54. Former IRS employees can obtain enrollment after:

- A. 1 year
- B. 2 years
- C. 5 years service
- D. 10 years

55. Enrolled retirement plan agent can practice on matters involving:

- A. Income tax
- B. Employee plans
- C. All tax matters
- D. Estates

56. Disbarment from practice before IRS is:

- A. Temporary
- B. Until reinstated
- C. Permanent
- D. Appealable

57. Reinstatement petition can be filed after:

- A. 5 years
- B. 3 years
- C. 2 years
- D. 1 year

58. Suspension from practice is for:

- A. Specific period

- B. Indefinite
- C. Permanent
- D. Life

59. Censure is public or private reprimand for:

- A. Serious violations
- B. Minor violations
- C. All violations
- D. First violations

60. Disciplinary proceedings are conducted by:

- A. Tax Court
- B. OPR
- C. Administrative Law Judge
- D. IRS Commissioner

61. Complaint and answer in disciplinary proceedings require response within:

- A. 30 days
- B. 90 days
- C. 60 days
- D. 45 days

62. Practitioner can appeal Administrative Law Judge decision to:

- A. Tax Court
- B. Treasury Secretary
- C. Appeals Office
- D. IRS Commissioner

63. Expedited suspension can occur when practitioner is:

- A. Suspended by state
- B. Under investigation
- C. Subject to penalty
- D. Convicted of crime

64. Immediate suspension applies when practitioner found guilty of:

- A. Negligence
- B. Tax crime
- C. Incompetence
- D. Violation

65. Monetary penalty for Circular 230 violation can be imposed in addition to:
- A. Censure only
  - B. Disbarment only
  - C. Suspension only
  - D. Other sanctions
66. Best practices are aspirational and:
- A. Mandatory
  - B. Enforceable
  - C. Not mandatory
  - D. Required
67. Practitioner must exercise due diligence in preparing returns and determining:
- A. Refund amount
  - B. Correctness of representations
  - C. Client honesty
  - D. Tax liability
68. Practitioner relying on advice of another must use reasonable care in selecting advisor and can rely if advisor is:
- A. Any professional
  - B. Attorney
  - C. Licensed
  - D. Competent
69. Practitioner cannot willfully, recklessly, or through gross incompetence give false or misleading information to:
- A. Client
  - B. IRS or Treasury
  - C. Courts
  - D. Public
70. Tax return positions must be disclosed if lacking substantial authority unless position has reasonable basis and is:
- A. Disclosed
  - B. Documented
  - C. Explained
  - D. Supported
71. Preparer must retain copy of return or list for:

- A. 1 year
- B. 3 years
- C. 7 years
- D. Permanent

72. Return information disclosure violations can result in penalties per disclosure of:

- A. \$100
- B. \$250
- C. \$500
- D. \$1,000

73. Signing preparer is identified by:

- A. Name only
- B. PTIN
- C. Address
- D. License number

74. Preparer penalties can apply to each return or claim prepared so total penalties can be:

- A. Unlimited
- B. \$25,000 maximum
- C. \$5,000 per year
- D. \$50,000

75. Unreasonable position penalty requires position to lack substantial authority or adequate disclosure with reasonable basis resulting in penalty of greater of \$1,000 or:

- A. 25% of income
- B. \$5,000
- C. 100% of income
- D. 50% of income

76. Willful or reckless conduct penalty is greater of \$5,000 or:

- A. 25% of income
- B. 75% of income
- C. 100% of income
- D. 50% of income

77. Failure to furnish identifying number results in penalty of:

- A. \$50
- B. \$100
- C. \$250

D. \$500

78. Failure to sign return results in penalty of:

- A. \$50
- B. \$100
- C. \$50 per return
- D. \$250

79. Aiding and abetting understatement results in penalty of \$1,000 individuals or:

- A. \$5,000 corporations
- B. \$25,000
- C. \$50,000
- D. \$10,000

80. Disclosure or use penalty applies per use or disclosure with maximum of:

- A. \$5,000 per year
- B. \$10,000 per year
- C. \$25,000
- D. Unlimited

81. Due diligence requirements apply to returns claiming EITC, CTC, AOTC, ACTC, and:

- A. HOH
- B. LLC
- C. Saver's Credit
- D. Education credits

82. Due diligence penalty is assessed per failure at:

- A. \$100
- B. \$500
- C. \$590
- D. \$1,000

83. Knowledge for due diligence means knew or reasonably:

- A. Could know
- B. Might know
- C. Should have known
- D. Would know

84. Form 8867 must be completed for each return claiming covered credits and retained for:

- A. 1 year

- B. 3 years
- C. 5 years
- D. 7 years

85. Preparer must make reasonable inquiries when information appears incorrect and cannot ignore implications of information furnished including information from:

- A. Client only
- B. Third parties
- C. Documents
- D. Public records

86. Record of questions asked and answers must be documented if information appears:

- A. Normal
- B. High
- C. Low
- D. Questionable

87. Electronic signatures on returns require specific IRS procedures and practitioner must verify identity of signer using:

- A. Password
- B. Knowledge-based authentication
- C. PIN
- D. ID check

88. ERO (Electronic Return Originator) responsibilities include reviewing return with taxpayer and obtaining:

- A. Payment
- B. Signature authorization
- C. Consent
- D. Approval

89. Self-select PIN allows taxpayer to sign electronically using prior year AGI or PIN and date of birth or:

- A. SSN
- B. Income
- C. Other information
- D. Address

90. Practitioner PIN allows representative to sign using PIN issued by IRS and requires:

- A. Nothing additional

- B. Client authorization
- C. Form 2848
- D. Form 8879

91. Electronic filing mandate applies to preparers filing more than:

- A. 5 returns
- B. 100 returns
- C. 11 returns
- D. 25 returns

92. Hardship waiver from e-file requirement must be requested on Form:

- A. 8948
- B. 8453
- C. 8879
- D. 9000

93. Paid preparer defined as anyone who prepares return for:

- A. Free
- B. Compensation
- C. Family
- D. Friend

94. Return preparer includes anyone who employs preparers and has final responsibility for return called:

- A. Owner
- B. Manager
- C. Supervisor
- D. Signing preparer

95. Nonsigning preparer subject to penalties must prepare substantial portion generally meaning tax liability or refund attributable to that portion exceeds lesser of \$10,000 or:

- A. 10% of tax or refund
- B. \$5,000
- C. 20%
- D. \$25,000

96. Substantial portion determination considers length, complexity, and:

- A. Fee
- B. Time
- C. Tax amounts

D. Difficulty

97. Schedules attached to return can create substantial portion if they affect:

- A. Filing status
- B. Credits or deductions
- C. Income
- D. All of above

98. Tax return preparer does not include those providing mechanical assistance like typing unless they provide:

- A. Advice
- B. Service
- C. Computation
- D. Preparation

99. Registered tax return preparer credential was discontinued effective:

- A. 2013
- B. 2015
- C. 2016
- D. 2014

100. Annual Filing Season Program is voluntary program providing limited practice rights and requires completion of tax law continuing education and passing comprehension test on Form:

- A. 1040
- B. 6251
- C. 1040 issues
- D. Schedule C

## Answer Explanations - Practice Test 6

### Part 1: Individuals

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#### 1. Correct Answer: A (April 15)

Tax returns for calendar year taxpayers are generally due by April 15 of the year following the tax year. If April 15 falls on a weekend or legal holiday, the due date is the next business day. For example, 2024 calendar year returns are due April 15, 2025. This deadline applies to Form 1040

and payment of any tax owed. Extensions of time to file (not to pay) can be obtained, but the original April 15 deadline is critical for calculating penalties and interest.

**2. Correct Answer: C (6 months)**

The automatic extension for individual tax returns (obtained by filing Form 4868 by the original due date) provides an additional 6 months to file. This extends the filing deadline from April 15 to October 15 for calendar year taxpayers. The extension is automatic if properly requested—the IRS doesn't need to approve it. However, the extension only applies to filing the return, not paying the tax. Any tax owed is still due by April 15, and interest and penalties accrue on unpaid balances from that date.

**3. Correct Answer: D (Pay tax owed)**

An extension of time to file does NOT extend the time to pay the tax owed. The tax payment is still due by the original filing deadline (April 15 for calendar year taxpayers). If taxpayers don't pay at least 90% of the actual tax liability by April 15, they may face failure-to-pay penalties and interest on the unpaid amount. The extension only provides additional time to complete and file the return itself.

**4. Correct Answer: B (April 15)**

For purposes of the statute of limitations on refund claims, returns filed before the due date are considered filed on the due date. If a taxpayer files on April 1 when the due date is April 15, the return is deemed filed on April 15. This rule prevents early filers from shortening their refund claim period. The 3-year statute for claiming refunds runs from the later of the due date or the actual filing date.

**5. Correct Answer: D (180 days plus service time)**

Combat zone extensions can extend filing and payment deadlines for at least 180 days after the last day in the combat zone, plus the period of continuous hospitalized injury, plus the period of continuous qualified service in the combat zone. This can result in extensions of several years for service members deployed to combat zones. The extension applies to filing returns, paying taxes, filing refund claims, and other tax-related deadlines.

**6. Correct Answer: A (15th day of 4th month after year-end)**

Fiscal year taxpayers must file returns by the 15th day of the 4th month after their fiscal year ends. For example, a fiscal year ending June 30 requires a return filed by October 15. A fiscal year ending September 30 requires filing by January 15. This parallels the April 15 deadline for calendar year taxpayers (15th day of 4th month after December 31).

**7. Correct Answer: C (June 15)**

Taxpayers who are U.S. citizens or residents living and working outside the United States on the regular due date automatically receive an extension to June 15 to file their returns. No formal extension request is required—the extension is automatic. Taxpayers must attach a statement to their return explaining which foreign country they resided in and that they qualified for the automatic 2-month extension. This extension also applies to the time to pay without penalties.

**8. Correct Answer: B (Extension to file)**

Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return, must be filed by the original due date (April 15 for calendar year taxpayers) to obtain an automatic 6-month extension to file. The IRS does not need to approve the extension—it's automatic if the form is properly filed. The form does not extend the time to pay taxes owed; it only extends the filing deadline.

**9. Correct Answer: A (Preparer error if reasonable reliance shown)**

Reasonable cause for late filing can include situations beyond the taxpayer's control, such as death or serious illness of the taxpayer or immediate family, unavoidable absence, destruction of records by fire or other casualty, or inability to obtain records. Preparer error may constitute reasonable cause if the taxpayer exercised ordinary business care and prudence, timely provided all necessary information to the preparer, and reasonably relied on the preparer's expertise. Lack of funds, forgetfulness, and being busy are not reasonable cause.

**10. Correct Answer: D (1040-X)**

Amended individual income tax returns are filed on Form 1040-X, Amended U.S. Individual Income Tax Return. The form shows the original amounts reported, the net changes, and the corrected amounts. Taxpayers use Form 1040-X to correct errors, claim additional deductions or credits, or report additional income. The form must include an explanation of the changes being made. Form 1040-X cannot be filed electronically in most cases.

**11. Correct Answer: C (3 years)**

Amended returns to claim refunds must generally be filed within 3 years from the date the original return was filed, or 2 years from the date the tax was paid, whichever is later. Returns filed before the due date are deemed filed on the due date for this purpose. For example, a 2024 return filed April 1, 2025 is deemed filed April 15, 2025, so the refund claim deadline is April 15, 2028.

**12. Correct Answer: B (2 years from payment)**

The statute of limitations for refund claims is the later of 3 years from the date the return was filed or 2 years from the date the tax was paid. This dual limitation ensures taxpayers have adequate time to discover overpayments whether they filed early or paid late. For example, if estimated taxes were paid in 2024 and the return was filed in 2025, the taxpayer has until 2 years from each payment (or 3 years from filing) to claim a refund.

### **13. Correct Answer: A (Taxpayer)**

Form 1040-X must be signed by the taxpayer under penalties of perjury. If it's a joint return, both spouses must sign. The preparer should also sign if they prepared the amended return. The signature requirement ensures the taxpayer takes responsibility for the changes being made and certifies that the amended return is true, correct, and complete.

### **14. Correct Answer: D (Pre-marriage debt)**

Injured spouse relief (Form 8379) helps a taxpayer recover their portion of a joint refund that was applied to the other spouse's past-due debts incurred before the marriage or separately. This includes past-due federal taxes, state taxes, child support, or student loans owed by the spouse. The injured spouse allocation divides the refund between spouses based on each spouse's contributions, allowing the injured spouse to receive their portion.

### **15. Correct Answer: C (2 years of notice)**

Actually, innocent spouse relief must be requested within 2 years after the IRS first begins collection activities against the requesting spouse. This differs from the refund claim statute. Form 8857, Request for Innocent Spouse Relief, is used. The 2-year deadline ensures timely relief requests while the IRS can still verify circumstances. Various types of relief are available: innocent spouse relief, separation of liability relief, and equitable relief.

### **16. Correct Answer: B (Separated or divorced)**

Equitable relief considers all facts and circumstances, including whether the spouses were separated or divorced at the time relief is requested, whether the requesting spouse would face economic hardship if relief is not granted, and whether the requesting spouse knew or had reason to know of the understatement. Equitable relief is available when traditional innocent spouse or separation of liability relief don't apply but it would be unfair to hold the requesting spouse liable.

### **17. Correct Answer: D (8857)**

Relief from joint liability (innocent spouse relief, separation of liability relief, or equitable relief) is requested on Form 8857, Request for Innocent Spouse Relief. The form requests detailed information about the marriage, the understatement or underpayment, and why the requesting spouse believes they should be relieved of liability. Form 8379 is for injured spouse allocation, not relief from liability.

### **18. Correct Answer: A (Tax is legally owed)**

Offer in compromise based on doubt as to liability questions whether the assessed tax is legally correct—whether the tax is actually owed. This type of offer is appropriate when there's a genuine dispute about the existence or amount of the tax liability. It's different from doubt as to collectibility (inability to pay the full amount) or effective tax administration (paying would create hardship or be unfair).

**19. Correct Answer: C (Interest and penalties)**

Installment agreements allow taxpayers to pay tax liabilities over time in monthly payments, but interest and applicable penalties continue to accrue on the unpaid balance until fully paid. The failure-to-pay penalty rate may be reduced from 0.5% to 0.25% per month while an installment agreement is in effect and the taxpayer is current. Interest rates are set quarterly based on the federal short-term rate plus 3 percentage points.

**20. Correct Answer: B (Hardship)**

Currently not collectible (CNC) status applies when the IRS determines that collection of the tax would create economic hardship for the taxpayer—the taxpayer cannot pay basic living expenses if required to pay the tax. While in CNC status, the IRS temporarily suspends collection activities, but the liability remains and the statute of limitations continues running. Interest and penalties continue accruing. The IRS periodically reviews CNC accounts to determine if the taxpayer's financial situation has improved.

**21. Correct Answer: A (\$25,000 for single)**

Social Security benefits become taxable when "combined income" (also called "provisional income") exceeds certain base amounts: \$25,000 for single filers, \$32,000 for married filing jointly, and \$0 for married filing separately (if living together at any time during the year). Combined income equals adjusted gross income plus nontaxable interest plus one-half of Social Security benefits. Above these thresholds, up to 50% or 85% of benefits may be taxable.

**22. Correct Answer: D (Half of Social Security)**

Provisional income (combined income) for determining Social Security taxability includes adjusted gross income, plus tax-exempt interest, plus half of Social Security benefits received. This formula determines whether Social Security benefits are taxable and what percentage is taxable. The calculation requires adding back tax-exempt interest to prevent taxpayers from sheltering income in tax-exempt bonds to avoid taxation of Social Security benefits.

**23. Correct Answer: B (85%)**

The maximum taxable portion of Social Security benefits is 85%. For single filers, up to 50% of benefits are taxable if combined income is between \$25,000 and \$34,000. Above \$34,000, up to 85% of benefits are taxable. For married filing jointly, the ranges are \$32,000-\$44,000 (50% taxable) and above \$44,000 (85% taxable). These thresholds are not indexed for inflation and have remained unchanged since they were enacted.

**24. Correct Answer: C (Social Security)**

Tier 1 railroad retirement benefits are treated like Social Security benefits for tax purposes. They're taxed using the same computation as Social Security benefits, with up to 85% potentially taxable depending on combined income. Tier 2 benefits are treated like pension income and are fully

taxable. The separation ensures railroad retirees are taxed comparably to Social Security recipients while accounting for the supplemental pension-like component.

**25. Correct Answer: D (Fully taxable)**

Disability income from an employer-paid insurance policy is fully taxable as wages or pension income. If the employee paid the premiums with after-tax dollars, the benefits are tax-free. If the employer and employee shared premium costs, the portion attributable to employer-paid premiums is taxable. Workers' compensation for work-related injuries is tax-exempt. Social Security disability benefits follow the same taxability rules as retirement benefits.

**26. Correct Answer: A (Tax-exempt)**

Workers' compensation benefits received for work-related injuries or illnesses are generally tax-exempt. However, if amounts are received as retirement benefits based on age, length of service, or prior contributions (rather than injury), those amounts are taxable as pension income. The tax-exempt treatment recognizes that workers' compensation replaces lost wages due to injury and shouldn't be subject to income tax.

**27. Correct Answer: B (Fully taxable)**

Unemployment compensation is fully taxable as ordinary income and must be reported on Form 1040. Recipients receive Form 1099-G showing the amount of unemployment benefits paid. There's no withholding requirement, but recipients can elect to have federal income tax withheld at 10%. The American Rescue Plan Act of 2021 provided a temporary \$10,200 exclusion for 2020 only, but unemployment is otherwise fully taxable.

**28. Correct Answer: C (Ordinary income)**

Severance pay received upon termination is taxable as ordinary wage income. It's subject to federal income tax withholding, Social Security and Medicare taxes, and is reported on Form W-2. Severance pay is compensation for services performed and for the agreement to terminate employment. It's not considered unemployment compensation and doesn't qualify for any special tax treatment.

**29. Correct Answer: A (Taxable)**

Strike benefits paid by a union to its members during a labor dispute are taxable income. They're reported as other income on Form 1040. Strike benefits replace wages that would have been earned, so they're taxed like wage income. However, they're not subject to Social Security and Medicare taxes because they're not wages from employment.

**30. Correct Answer: D (Fully taxable)**

Punitive damages from lawsuits are fully taxable as ordinary income, regardless of the underlying reason for the lawsuit. Unlike compensatory damages for physical injuries (which can be tax-

exempt), punitive damages are intended to punish the wrongdoer rather than compensate for actual losses. Therefore, punitive damages are always taxable, even when the underlying lawsuit involves physical injury.

**31. Correct Answer: C (Tax-exempt)**

Compensatory damages for physical injury or physical sickness are tax-exempt. This includes damages for lost wages due to physical injury, pain and suffering, and medical expenses (though medical expense deductions previously taken may need to be included in income). The exclusion applies only to damages for physical injuries—emotional distress damages are taxable unless attributable to physical injury.

**32. Correct Answer: B (Taxable)**

Emotional distress damages not related to physical injury or sickness are taxable. However, the portion of emotional distress damages allocated to medical care expenses is excluded from income. For example, if emotional distress damages include payments for psychological therapy, those medical expense amounts are tax-exempt. Emotional distress stemming from physical injury or sickness is excluded from income along with the physical injury damages.

**33. Correct Answer: D (Above-the-line)**

Attorney fees and court costs in employment discrimination cases, civil rights claims, whistleblower claims, and certain other unlawful discrimination claims can be deducted as an adjustment to income (above-the-line) on Schedule 1. This deduction is limited to the amount of the judgment or settlement included in income. The above-the-line treatment prevents the 2% miscellaneous itemized deduction limitation (which was eliminated for 2018-2025) from applying.

**34. Correct Answer: A (Taxable)**

Alaska Permanent Fund dividends are taxable income that must be reported on federal tax returns. Alaska distributes annual dividends to residents from investment earnings of the Alaska Permanent Fund, which was established with oil revenues. While Alaska has no state income tax, these dividends are fully taxable for federal income tax purposes. Recipients receive Form 1099-MISC reporting the dividend amount.

**35. Correct Answer: C (Itemized in prior year)**

State tax refunds are taxable to the extent the taxpayer received a tax benefit from deducting state taxes in a prior year. If the taxpayer itemized deductions and claimed state income taxes on Schedule A in the prior year, a refund of those taxes is taxable in the year received (reported on Form 1099-G). If the taxpayer took the standard deduction, the refund is not taxable because no tax benefit was received from the state tax payment.

**36. Correct Answer: B (Form 1040)**

Gambling winnings are reported directly on Form 1040 as other income. Professional gamblers report on Schedule C. Certain gambling winnings over threshold amounts are reported to taxpayers and the IRS on Form W-2G. Gambling winnings include lottery prizes, casino winnings, racetrack payouts, and prize money. All gambling winnings are taxable, even if not reported on W-2G.

**37. Correct Answer: A (Gambling winnings)**

Gambling losses are deductible as an itemized deduction on Schedule A, but only up to the amount of gambling winnings reported as income. Losses cannot exceed winnings—taxpayers cannot use gambling losses to create an overall loss. Professional gamblers can deduct losses as business expenses on Schedule C without the limitation. Adequate records must be maintained documenting both winnings and losses.

**38. Correct Answer: D (Schedule C)**

Professional gamblers (those who gamble as a trade or business, not recreationally) report gambling income and expenses on Schedule C, Profit or Loss from Business. This allows them to deduct gambling losses and expenses against gambling income without the gambling loss limitations that apply to casual gamblers. Professional gambler status requires showing gambling is pursued full-time with regularity and continuity for income or livelihood.

**39. Correct Answer: C (Form 1040)**

Hobby income must be reported on Form 1040 as other income. After the Tax Cuts and Jobs Act, hobby expenses are not deductible (previously they were deductible as miscellaneous itemized deductions subject to 2% of AGI floor, limited to hobby income). The elimination of miscellaneous itemized deductions for 2018-2025 means hobbyists pay tax on gross income without expense deductions.

**40. Correct Answer: B (Not deductible)**

After the Tax Cuts and Jobs Act suspended miscellaneous itemized deductions for 2018-2025, hobby expenses are not deductible at all. Previously, hobby expenses were deductible as miscellaneous itemized deductions subject to the 2% of AGI floor and limited to hobby income. The current law creates a significant tax burden for hobby activities with substantial expenses, since all income is taxable but expenses aren't deductible.

**41. Correct Answer: D (Fully taxable)**

Jury duty pay is fully taxable and must be reported as other income on Form 1040. If the employer continues paying salary during jury duty and requires the jury pay to be turned over, the employee reports the jury pay as income but can deduct the amount turned over to the employer as an adjustment to income on Schedule 1. This prevents double taxation when jury pay goes to the employer.

**42. Correct Answer: A (Tax-exempt up to \$2,000)**

Election worker pay up to \$2,000 per year can be excluded from income for individuals age 18 or older who work as election officials or workers for state or local governments. This exclusion encourages civic participation in the election process. Amounts over \$2,000 are taxable. The exclusion applies to wages, not self-employment income, and the worker must be paid by a state or local government.

**43. Correct Answer: C (Fully taxable)**

Notary public fees are fully taxable as self-employment income and must be reported on Schedule C (or Schedule C-EZ). Notaries are considered self-employed for tax purposes, so the income is subject to both income tax and self-employment tax. Related expenses (supplies, bond fees, education) are deductible on Schedule C. Even if notary services are a sideline to regular employment, the notary fees are self-employment income.

**44. Correct Answer: B (\$20 per month)**

Employees must report tips to their employer if they receive \$20 or more in tips in any month. The employer uses this information to withhold income, Social Security, and Medicare taxes. Employees use Form 4070 or electronic systems to report tips monthly. All tips are taxable income regardless of the reporting threshold—the \$20 threshold just determines when employer reporting is required.

**45. Correct Answer: A (Already included in wages)**

Allocated tips shown on Form W-2 Box 8 have already been included in Box 1 wages and Box 7 Social Security tips. Allocated tips are the employee's share of tips assigned by the employer when reported tips are less than 8% of sales for large food and beverage establishments. While allocated tips are included in income, they're not subject to withholding. Employees should ensure their reported tips (Box 7) reflect actual tips received.

**46. Correct Answer: D (Schedule 3)**

Credit for excess Social Security tax withheld by multiple employers is claimed on Schedule 3 (Part II, Nonrefundable Credits) which flows to Form 1040. When an employee works for multiple employers and total wages exceed the Social Security wage base (\$168,600 for 2024), excess Social Security tax may be withheld. The employee receives credit for the excess on their tax return. This only applies to multiple employers—single employer overwithholding must be corrected by the employer.

**47. Correct Answer: C (\$200,000 single)**

Additional Medicare Tax of 0.9% applies to wages exceeding \$200,000 for single filers, \$250,000 for married filing jointly, and \$125,000 for married filing separately. Employers must withhold the additional tax when individual wages exceed \$200,000, regardless of the employee's filing status.

This can create underwithholding or overwithholding for married couples. The tax applies to wages, self-employment income, and railroad retirement compensation.

**48. Correct Answer: B (SE)**

Self-employment tax is calculated on Schedule SE, Self-Employment Tax. The schedule computes self-employment tax on net earnings from self-employment (92.35% of net profit from Schedule C, F, or partnership). The tax equals 15.3% (12.4% Social Security + 2.9% Medicare) on earnings up to the Social Security wage base, plus 2.9% Medicare tax on all earnings above that. One-half of self-employment tax is deductible as an adjustment to income.

**49. Correct Answer: D (Ministerial services)**

Ministers can elect to be exempt from self-employment tax on their ministerial earnings by filing Form 4361, but only if they're opposed to public insurance on religious grounds or conscientiously opposed due to religious principles. The election must be filed by the due date of the tax return for the second tax year in which they have net earnings of \$400 or more from ministerial services. The exemption is irrevocable and applies only to ministerial income.

**50. Correct Answer: A (1917-1921)**

The "notch years" refer to persons born between 1917 and 1921 who received lower Social Security benefits than those born slightly earlier or later, due to a 1977 change in the benefit calculation formula that fixed an earlier error. This created a "notch" in benefit amounts. While referred to in Social Security discussions, the notch primarily relates to benefit amounts, not taxation. Understanding the term helps with client discussions but doesn't directly affect tax calculations.

**51. Correct Answer: C (Lump sum election)**

When Social Security recipients receive lump sum payments for prior years (retroactive benefits), they can elect to tax the lump sum by attributing it to the prior year(s) when it should have been received, rather than including it all in the current year. This election can reduce taxes if the taxpayer was in a lower bracket in prior years or below the taxability thresholds. The election is made by completing a "Notice of Lump-Sum Benefits" worksheet.

**52. Correct Answer: B (Credit or deduction choice)**

If a taxpayer repays Social Security or railroad retirement benefits of more than \$3,000 in the same year they were included in income, they can choose to either (1) take an itemized deduction for the repayment on Schedule A, or (2) claim a credit for the tax paid on the repaid amount. The credit is generally more favorable. If repayment is \$3,000 or less, an itemized deduction is the only option.

**53. Correct Answer: A (Pension)**

Tier 2 railroad retirement benefits are taxed as pension income and are fully taxable. They're not subject to the Social Security taxation computation. Tier 2 benefits are similar to private pension benefits and represent supplemental annuity payments based on railroad service. Recipients report Tier 2 benefits on Form 1040 as taxable pensions, while Tier 1 benefits are reported with Social Security benefits.

**54. Correct Answer: D (Wages)**

Disability pensions received before reaching minimum retirement age are taxed as wages and reported on Form 1040 as wages. They're subject to income tax withholding but not Social Security and Medicare taxes after the first calendar year after the employee last worked. After reaching minimum retirement age, disability payments are taxed as pension income. Minimum retirement age is the earliest age at which the employee could receive pension benefits if not disabled.

**55. Correct Answer: B (Age-based table)**

The simplified method for pension taxation uses age-based tables to determine the tax-free portion of pension payments. The method applies to qualified retirement plan annuities if the annuity starting date is after November 18, 1996. The taxpayer divides total contributions (basis) by an age-based expected number of payments from IRS tables. This determines the tax-free amount per payment. Any remaining basis after full recovery is tax-free.

**56. Correct Answer: C (Exclusion ratio)**

The general rule for annuities uses an exclusion ratio to determine the tax-free portion of each payment. The exclusion ratio equals investment in the contract (basis) divided by expected return (total expected payments). This ratio is applied to each payment to determine the tax-free portion. The general rule typically applies to commercial annuities and situations where the simplified method doesn't apply.

**57. Correct Answer: D (10 years)**

Non-spouse beneficiaries of inherited IRAs (post-SECURE Act for deaths after 2019) must generally withdraw the entire account within 10 years of the account owner's death. Annual required minimum distributions during the 10-year period may apply depending on when the original owner died. This "10-year rule" replaced the previous "stretch IRA" provision that allowed distributions over the beneficiary's lifetime.

**58. Correct Answer: A (5 years and age 59½)**

Designated Roth accounts in 401(k) or 403(b) plans have qualified distributions after the account has been open for 5 years AND the participant reaches age 59½ (or becomes disabled or dies). Both requirements must be met. Unlike Roth IRAs, the 5-year period for designated Roth accounts in employer plans starts when the first contribution is made to that particular plan, not to any Roth account.

**59. Correct Answer: B (Taxable income)**

In-plan Roth conversions (converting traditional 401(k) or 403(b) amounts to designated Roth accounts within the same plan) create taxable income equal to the converted amount. The conversion is not subject to the 10% early distribution penalty. The converted amount becomes the basis in the Roth account. Future qualified distributions of the converted amount and earnings will be tax-free if requirements are met.

**60. Correct Answer: C (59½)**

Substantially equal periodic payments under Section 72(t) must continue for the greater of 5 years or until age 59½ to avoid the 10% early distribution penalty. For example, if payments start at age 56, they must continue until age 61 (5 years). If started at age 45, they must continue until age 59½ (14.5 years). Modifying or discontinuing payments before the required period triggers retroactive penalties and interest.

**61. Correct Answer: A (RMD)**

Qualified charitable distributions (QCDs) from IRAs count toward satisfying the required minimum distribution for the year. QCDs allow taxpayers age 70½ or older to donate up to \$105,000 annually (2024, indexed) directly from IRAs to qualified charities. The distribution is excluded from income and satisfies RMD requirements. This provides tax benefits even for taxpayers who don't itemize deductions.

**62. Correct Answer: D (Own IRA)**

A surviving spouse beneficiary can elect to treat an inherited IRA as their own IRA, allowing them to delay required minimum distributions until they reach RMD age. Alternatively, the spouse can remain a beneficiary and take distributions based on their life expectancy. The option to treat as their own provides greater flexibility and can minimize distributions. Non-spouse beneficiaries don't have this option.

**63. Correct Answer: B (Conversion)**

Roth IRA conversions are taxable in the year of conversion. The taxable amount equals the value converted minus any nondeductible contributions (basis) in traditional IRAs. The conversion is not subject to the 10% early distribution penalty. Each conversion starts its own 5-year holding period for purposes of penalty-free withdrawal of the converted amount. Earnings must meet the qualified distribution requirements.

**64. Correct Answer: C (10%)**

The Saver's Credit percentages are 50%, 20%, or 10% of qualified retirement contributions (up to \$2,000), depending on adjusted gross income and filing status. The percentage decreases as income increases. For 2024, the 50% rate applies to single filers with AGI up to approximately \$23,000,

the 20% rate applies from \$23,001-\$25,000, and the 10% rate applies from \$25,001-\$38,250. Above the upper threshold, no credit is available.

**65. Correct Answer: A (Taxable distribution)**

Retirement plan loans exceeding limits (generally greater of \$10,000 or 50% of vested balance, up to \$50,000) are treated as taxable distributions. The excess over the limit is included in income and subject to the 10% early distribution penalty if under age 59½. Properly structured loans within limits are not taxable if repaid according to the plan's loan terms. Defaulted loans also create taxable distributions.

**66. Correct Answer: D (3 years)**

Qualified disaster retirement distributions (up to \$100,000 per disaster) can be repaid to eligible retirement plans within 3 years. Repayments are treated as rollovers and allow the taxpayer to recover taxes paid on the distribution. Income from the distribution can be spread over 3 years. The 10% early distribution penalty doesn't apply. This relief applies to federally declared disasters affecting the taxpayer.

**67. Correct Answer: C (\$100,000)**

Coronavirus-related distributions (CRDs) available in 2020 under the CARES Act allowed withdrawals up to \$100,000 from retirement plans without the 10% early distribution penalty. The income could be spread over 3 years, and amounts could be repaid within 3 years as rollovers. CRDs applied to individuals affected by COVID-19 through diagnosis, financial consequences, or inability to work due to pandemic impacts.

**68. Correct Answer: B (Taxable but penalty-free)**

Hardship distributions from 401(k) plans are taxable as ordinary income but may be exempt from the 10% early distribution penalty if they meet safe harbor requirements (medical expenses, home purchase, education expenses, etc.). However, TCJA eliminated the penalty exception for hardship distributions not meeting specific safe harbor requirements. Hardship distributions cannot be rolled over and permanently reduce retirement savings.

**69. Correct Answer: D (IRS-approved methods)**

Substantially equal periodic payments (Section 72(t)) must use one of three IRS-approved methods: required minimum distribution method, fixed amortization method, or fixed annuitization method. These methods calculate payment amounts based on life expectancy and account balance. Once started, the method generally cannot be changed without triggering penalties. The RMD method allows annual recalculation, while the other methods lock in payment amounts.

**70. Correct Answer: A (180 days or more)**

Qualified reservist distributions are penalty-free if the taxpayer is a member of the reserves called to active duty for more than 179 days (at least 180 days) or for an indefinite period. The distribution must occur during the active duty period. The distribution is still taxable but exempt from the 10% early distribution penalty. Reservists can repay these distributions to IRAs during the 2-year period after active duty ends.

**71. Correct Answer: C (8606)**

Basis in traditional IRAs (nondeductible contributions) is tracked on Form 8606, Nondeductible IRAs. The form calculates the tax-free and taxable portions of IRA distributions based on the ratio of total basis to total IRA balance. Taxpayers must file Form 8606 for any year they make nondeductible IRA contributions or take distributions when basis exists. Failure to file can result in double taxation of nondeductible contributions.

**72. Correct Answer: B (6%)**

Excess contributions to Roth IRAs (or traditional IRAs) are subject to a 6% excise tax for each year the excess remains in the account. The excess can be corrected by withdrawing the excess plus earnings before the tax return due date (including extensions), or by applying the excess to future years' contributions. The 6% penalty continues annually until corrected, creating significant costs for uncorrected excess contributions.

**73. Correct Answer: D (Tuition, fees, books, supplies)**

Qualified education expenses for the IRA early distribution penalty exception include tuition, fees, books, supplies, and equipment required for enrollment or attendance at eligible educational institutions. Room and board qualify if the student is enrolled at least half-time. The exception applies to expenses for the taxpayer, spouse, or any child or grandchild. Graduate school expenses qualify. The distribution is still taxable but not subject to the 10% penalty.

**74. Correct Answer: A (2 years)**

The first-time homebuyer exception to the IRA early distribution penalty applies if the taxpayer (or spouse, child, grandchild, or ancestor) had no present ownership interest in a principal residence during the 2-year period ending on the date of acquisition of the new home. The definition of "first-time" is based on this 2-year period. The penalty exception is limited to \$10,000 lifetime per person.

**75. Correct Answer: C (12 weeks)**

Health insurance premium distributions from IRAs are penalty-free if the taxpayer has received unemployment compensation for 12 consecutive weeks and the distribution is made during the unemployment or within 60 days of reemployment. The distribution can pay health insurance premiums for the taxpayer, spouse, and dependents. This exception recognizes that unemployed individuals may need IRA funds to maintain health coverage.

**76. Correct Answer: B (\$5,000)**

The qualified birth or adoption distribution limit is \$5,000 per child from IRAs and employer plans. The distribution must be made within one year of the birth or finalization of adoption. The distribution is not subject to the 10% early withdrawal penalty but is still taxable. Amounts can be repaid to eligible retirement plans as rollovers. Married couples can each take \$5,000 from their respective accounts for the same child.

**77. Correct Answer: A (10%)**

The tax on early distributions from IRAs before age 59½ is 10% of the taxable amount distributed. This penalty is in addition to regular income tax on the distribution. Numerous exceptions exist including disability, death, substantially equal periodic payments, qualified higher education expenses, first-time home purchase (\$10,000 lifetime), medical expenses exceeding 7.5% of AGI, health insurance premiums during unemployment, qualified birth/adoption, and qualified reservist distributions.

**78. Correct Answer: D (25%)**

Early distributions from SIMPLE IRAs during the first 2 years of participation are subject to a 25% early withdrawal penalty instead of the usual 10%. This increased penalty discourages early withdrawals from SIMPLE plans. After 2 years of participation, the standard 10% penalty applies. The same exceptions that apply to traditional IRA penalties (age 59½, disability, death, etc.) also apply to SIMPLE IRAs.

**79. Correct Answer: C (Earnings)**

Roth IRA ordering rules for distributions treat amounts as coming first from regular contributions (always tax and penalty-free), then from conversion contributions (tax-free but possibly subject to penalty if withdrawn within 5 years of conversion), and finally from earnings (taxable and potentially subject to penalty unless the distribution is qualified). This ordering ensures the most favorable tax treatment for distributions.

**80. Correct Answer: B (Each conversion)**

The 5-year holding period for avoiding the 10% early withdrawal penalty on converted amounts applies separately to each Roth conversion. If multiple conversions are made in different years, each has its own 5-year clock. For example, a 2020 conversion must be held until 2025 to avoid penalty on withdrawal of converted amounts. This is separate from the 5-year rule for qualified distributions of earnings.

**81. Correct Answer: D (\$165,000)**

The student loan interest deduction begins phasing out for married filing jointly when modified AGI exceeds \$165,000 for 2024, with complete phase-out at \$195,000. For single filers, the range is \$80,000-\$95,000. The deduction is up to \$2,500 of student loan interest paid. The phase-out is

proportional within the range. Above the upper limit, no deduction is available regardless of interest paid.

**82. Correct Answer: A (Qualified education loan)**

Private student loan interest is deductible if the loan is a qualified education loan—a loan used solely to pay qualified education expenses for the taxpayer, spouse, or dependent, and the student must be enrolled at least half-time in a degree program. The source of the loan (bank, credit union, private lender, or federal program) doesn't matter for deductibility. The key is that the loan was used for qualified education expenses.

**83. Correct Answer: C (Parent)**

Student loan interest paid by a parent on behalf of a dependent student who is liable on the loan is treated as paid by the student for deduction purposes. However, if the student is claimed as a dependent, the student cannot claim the deduction. The parent also cannot claim the deduction because the parent isn't legally obligated on the loan. This creates a gap where the interest may not be deductible by either party when the student is a dependent.

**84. Correct Answer: B (2024)**

Starting in 2024, qualified tuition program (529 plan) beneficiaries can roll over up to \$35,000 lifetime from 529 plans to Roth IRAs. The 529 account must have been open for at least 15 years. Contributions and earnings from the last 5 years aren't eligible for rollover. Annual rollovers are limited to the Roth IRA contribution limit. This provides an option for unused 529 funds without penalty.

**85. Correct Answer: A (Gift tax exclusion)**

ABLE account contribution limits equal the annual gift tax exclusion (\$18,000 for 2024). ABLE accounts are tax-advantaged savings accounts for individuals with significant disabilities that began before age 26. Contributions aren't federally deductible (some states offer deductions), but earnings grow tax-free and distributions for qualified disability expenses are tax-free. The beneficiary can contribute an additional amount equal to their compensation up to the federal poverty level.

**86. Correct Answer: D (Filing deadline)**

Coverdell Education Savings Account contributions must be made by the tax return filing deadline (not including extensions) for the tax year for which they're designated. For most taxpayers, this is April 15 of the following year. This parallels IRA contribution deadlines. Contributions can be designated for the current year or the prior year (if made between January 1 and April 15), similar to IRA contribution timing.

**87. Correct Answer: C (\$10,000 per year)**

Qualified tuition programs (529 plans) can distribute up to \$10,000 per year per beneficiary for K-12 tuition at public, private, or religious elementary or secondary schools. This provision was added by the Tax Cuts and Jobs Act. The \$10,000 limit is per beneficiary, so families with multiple children can take \$10,000 per child. Distributions for K-12 expenses other than tuition don't qualify for tax-free treatment.

**88. Correct Answer: B (Married filing separately)**

Education credits (American Opportunity and Lifetime Learning) cannot be claimed by taxpayers filing married filing separately. Other requirements include: the student must be enrolled at an eligible institution, the taxpayer must pay qualified education expenses, no one else can claim the student as a dependent (for AOTC), and the taxpayer's MAGI must be below phase-out limits. Married couples must file jointly to claim education credits.

**89. Correct Answer: D (\$2,000)**

The American Opportunity Tax Credit equals 100% of the first \$2,000 of qualified education expenses plus 25% of the next \$2,000, for a maximum credit of \$2,500 per eligible student. The credit is 40% refundable (up to \$1,000). Qualified expenses include tuition, fees, and course materials (books, supplies, equipment). The credit is available for the first four years of post-secondary education.

**90. Correct Answer: A (20%)**

The Lifetime Learning Credit rate is 20% of up to \$10,000 in qualified education expenses, for a maximum credit of \$2,000 per tax return (not per student). Unlike AOTC, there's no limit on the number of years the credit can be claimed, and it applies to undergraduate, graduate, and professional degree courses. The credit is nonrefundable—it can only reduce tax to zero, not create a refund.

**91. Correct Answer: C (Room and board)**

Qualified education expenses for education credits include tuition, required fees, and course materials (books, supplies, equipment required for courses). Room and board, insurance, medical expenses, transportation, and personal living expenses are not qualified expenses for credits. However, scholarships used for room and board are taxable to the student. The definition of qualified expenses varies between different education tax benefits.

**92. Correct Answer: B (Income)**

Education credits directly reduce tax liability dollar-for-dollar, while the tuition and fees deduction (which expired after 2020) reduced income when calculating adjusted gross income. Credits are generally more valuable than deductions because they provide a full dollar of tax savings for each dollar of credit, while deductions only save taxes at the taxpayer's marginal rate. The AOTC provides both tax reduction and potential refund.

**93. Correct Answer: A (American Opportunity Credit)**

The Hope Scholarship Credit was replaced and expanded by the American Opportunity Tax Credit starting in 2009. The AOTC increased the maximum credit from \$1,800 to \$2,500, made it partially refundable (40%), allowed it for four years of post-secondary education instead of two, expanded qualified expenses to include course materials, and increased income phase-out ranges. The AOTC has been extended multiple times.

**94. Correct Answer: D (Educational institution)**

Form 1098-T, Tuition Statement, is provided by educational institutions to students who paid qualified tuition and related expenses. The form shows amounts paid or amounts billed (depending on the institution's reporting method), scholarships and grants, and adjustments from prior years. Students use Form 1098-T to help determine education credit eligibility and calculate the credit amount. Not all payments shown qualify for credits.

**95. Correct Answer: B (Required for enrollment)**

Student activity fees are qualified education expenses for education credits only if the fees are required as a condition of enrollment or attendance. Optional or voluntary activity fees don't qualify. The same rule applies to course-related books, supplies, and equipment for AOTC—they must be required for the course. Required fees include lab fees, student activity fees required of all students, and other mandatory fees.

**96. Correct Answer: C (Tax-free scholarships)**

Education tax benefits (credits or deductions) cannot be claimed for the same expenses paid with tax-free educational assistance, including scholarships, grants, employer educational assistance, veterans' benefits, or distributions from 529 plans or Coverdell ESAs. However, if scholarship amounts exceed qualified expenses, the excess can be treated as taxable income to the student, freeing up paid expenses to claim for credits.

**97. Correct Answer: D (Loans paid with student funds)**

Qualified education expenses can be paid with cash, checks, credit cards, or student loan proceeds. As long as the expenses are paid and the student or parent is liable for the payment, the method doesn't matter for claiming credits. Loan proceeds become the student's funds when disbursed, so expenses paid with loans qualify. The key is that expenses must be paid to claim the credit—merely incurring expenses isn't sufficient.

**98. Correct Answer: A (Graduate or undergraduate)**

Employer educational assistance programs can exclude up to \$5,250 per year for both undergraduate and graduate courses under Section 127. The courses don't need to be job-related, and the degree doesn't need to be job-related. Starting in 2020, the \$5,250 can also include

employer student loan repayment assistance (through 2025). Amounts over \$5,250 are taxable unless they qualify as working condition fringe benefits.

**99. Correct Answer: C (Job-related)**

Working condition fringe benefits for education require that the education maintain or improve skills required in the employee's current job, or are required by the employer or by law to keep the employee's current salary, status, or job. The education cannot qualify the employee for a new trade or business. Employer payments for job-required education can be excluded beyond the \$5,250 Section 127 limit.

**100. Correct Answer: B (Tuition and required fees)**

Scholarship income for degree candidates is tax-free if used for qualified education expenses: tuition and fees required for enrollment or attendance, and course-related fees, books, supplies, and equipment required of all students in the course. Amounts used for room and board, travel, research, clerical help, or optional equipment are taxable. Scholarship amounts for services (teaching, research assistantships) are taxable as wages.

## **Part 2: Businesses**

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**1. Correct Answer: B (Earned)**

Accrual method taxpayers recognize income when it is earned (all events have occurred that fix the right to receive income and the amount can be determined with reasonable accuracy), not when cash is received. This is the "all events test" for income recognition. For example, a business that performs services in December 2024 recognizes income in 2024 even if payment isn't received until January 2025. The accrual method better matches income with the period in which it's earned.

**2. Correct Answer: D (Paid)**

Cash method businesses recognize expenses when actually paid, not when incurred, contracted, invoiced, or accrued. Cash method taxpayers report income when received and deduct expenses when paid. This provides simplicity and matches cash flow. However, certain expenses like prepaid interest must be allocated to the periods they benefit, and inventory must be accounted for even by cash method businesses.

**3. Correct Answer: A (Services provided)**

Economic performance for services received by the taxpayer occurs when the services are actually provided to the taxpayer, not when they're contracted, invoiced, or agreed upon. This requirement under the accrual method ensures expenses aren't deducted before the benefit is received. For services provided by the taxpayer to others, economic performance occurs when the taxpayer

provides the services. Economic performance is the third requirement of the all events test for accrual method deductions.

#### **4. Correct Answer: C (12 months or tax year-end of following year)**

The 12-month rule allows cash and accrual method taxpayers to deduct prepaid expenses if the benefit doesn't extend beyond 12 months after the first date on which the taxpayer realizes the benefit, or beyond the end of the tax year following the year of payment, whichever is later. For example, a calendar-year taxpayer paying rent on September 1, 2024 for the period through August 31, 2025 can deduct the entire amount in 2024 because the benefit doesn't extend beyond 12 months.

#### **5. Correct Answer: B (Economic performance)**

The all events test for accrual method deductions requires: (1) all events have occurred that fix the liability, (2) the amount can be determined with reasonable accuracy, and (3) economic performance has occurred. Economic performance generally occurs when property or services are provided to or by the taxpayer. This three-part test prevents premature deduction of expenses before the underlying obligation is satisfied.

#### **6. Correct Answer: A (IRS approval to change)**

Inventory accounting methods must be consistently applied from year to year and require IRS approval to change. A change in inventory method is a change in accounting method requiring Form 3115 and IRS consent. Consistency prevents taxpayers from manipulating income by changing methods. The choice of inventory method (FIFO, LIFO, specific identification, average cost) can significantly impact taxable income and tax liability.

#### **7. Correct Answer: D (Taxable)**

LIFO reserve increases (when current year LIFO inventory is valued at lower amounts than under FIFO due to inflation) create additional cost of goods sold deductions that reduce taxable income. Conversely, LIFO reserve decreases (when LIFO layers are liquidated and older, lower-cost inventory is matched against revenue) create taxable income. The LIFO reserve is the difference between inventory valued under FIFO and LIFO, tracking the cumulative effect of using LIFO.

#### **8. Correct Answer: C (Financial statements)**

The LIFO conformity rule requires that if LIFO is used for tax purposes, it must also be used in the primary financial statements provided to shareholders, creditors, or others. This prevents businesses from using LIFO for tax benefits (lower taxable income during inflation) while reporting higher income to investors using FIFO. The conformity rule ensures consistency between tax and financial reporting for inventory valuation.

#### **9. Correct Answer: A (Weighted average)**

The average cost method for inventory calculates cost as a weighted average of all units available for sale during the period. Total cost of goods available for sale is divided by total units available to determine average cost per unit. This average cost is then applied to units sold and units remaining in inventory. The weighted average method smooths out price fluctuations and is simpler than specific identification.

**10. Correct Answer: B (Occurs)**

Inventory write-downs to market value (lower of cost or market) are deductible when the decline in value actually occurs and is established, not when merely anticipated, planned, or estimated. The taxpayer must be able to demonstrate that inventory has actually declined in value below cost due to damage, obsolescence, or market price decreases. Conservative estimates of future declines are not deductible until the decline materializes.

**11. Correct Answer: D (Worthless)**

Business bad debt deductions require that the debt be worthless—totally or partially uncollectible. Mere delinquency or lateness doesn't establish worthlessness. Factors indicating worthlessness include bankruptcy of the debtor, debtor's disappearance, futility of collection efforts, and passage of significant time without payment. Businesses should document worthlessness with collection efforts, correspondence, and analysis of the debtor's financial condition.

**12. Correct Answer: C (Specific debt)**

The specific charge-off method (required for most businesses after reserve methods were eliminated) requires identifying and writing off specific debts that have become worthless. The business must demonstrate that specific accounts receivable are worthless and charge them off on its books. Estimates of overall bad debt rates are not acceptable—each debt must be identified individually as worthless.

**13. Correct Answer: B (Small banks)**

The reserve method for bad debts was generally eliminated by the Tax Reform Act of 1986, except for certain small banks (banks with assets under \$500 million). Most businesses must use the specific charge-off method, writing off individual debts when they become worthless. The elimination of reserve methods prevents over-reserving and premature deductions for estimated future bad debts that may never materialize.

**14. Correct Answer: A (Business bad debts)**

Loans between family members or related parties are presumed to be nonbusiness bad debts unless the taxpayer can demonstrate a business purpose for the loan. Business bad debts are deductible as ordinary losses on Schedule C or against business income. Nonbusiness bad debts are deductible only as short-term capital losses, subject to the \$3,000 annual limitation. The distinction significantly impacts tax treatment.

**15. Correct Answer: C (Ordinary loss)**

Business bad debts (debts created or acquired in connection with the taxpayer's trade or business) are deductible as ordinary losses in the year they become worthless. The deduction is taken on Schedule C or against business income, and the full loss can offset ordinary income without limitation. This treatment recognizes that business bad debts are ordinary business expenses, not investment losses.

**16. Correct Answer: D (Short-term capital loss)**

Nonbusiness bad debts (debts not created or acquired in connection with the taxpayer's trade or business, such as personal loans to friends or family) are treated as short-term capital losses when they become totally worthless. Partial worthlessness of nonbusiness bad debts cannot be deducted. The short-term capital loss treatment means nonbusiness bad debts can offset capital gains, plus up to \$3,000 of ordinary income annually, with excess losses carrying forward.

**17. Correct Answer: A (Business bad debt)**

When a taxpayer guarantees a business loan and makes payments when the primary debtor defaults, the guarantor's payments can be deducted as business bad debts if the guarantee was made in connection with the taxpayer's trade or business (such as guaranteeing a loan to protect a supplier or customer relationship). If the guarantee was not business-related, the payments are nonbusiness bad debts (short-term capital losses).

**18. Correct Answer: B (Last day of tax year)**

Worthless securities are treated as becoming worthless on the last day of the tax year in which they become totally worthless, creating a capital loss. This timing rule provides a clear date for reporting the loss even when the exact worthlessness date is unclear. Shareholders must prove total worthlessness—mere significant decline in value isn't sufficient. Corporate bankruptcy or dissolution often establishes worthlessness.

**19. Correct Answer: C (\$100,000)**

Section 1244 small business stock allows shareholders to claim ordinary loss treatment (instead of capital loss) on losses from the sale or worthlessness of qualifying stock. The ordinary loss limit is \$50,000 per year for single filers and \$100,000 for married filing jointly. Losses exceeding these limits are treated as capital losses. The company must meet requirements including total capital under \$1 million when stock is issued.

**20. Correct Answer: D (2017)**

The domestic production activities deduction under Section 199 was repealed for tax years beginning after December 31, 2017, by the Tax Cuts and Jobs Act. This deduction had allowed taxpayers to deduct up to 9% of qualified production activities income from U.S. manufacturing

and production. It was replaced with broader benefits including lower corporate tax rates (21%) and the Section 199A qualified business income deduction for pass-through entities.

**21. Correct Answer: B (20%)**

The Section 199A qualified business income deduction allows taxpayers to deduct up to 20% of qualified business income from partnerships, S corporations, and sole proprietorships, plus 20% of qualified REIT dividends and publicly traded partnership income. The deduction is subject to limitations based on type of business, taxable income, W-2 wages paid, and property used in the business. The deduction was enacted by TCJA to provide parity between pass-through and corporate taxation.

**22. Correct Answer: C (\$191,950 single)**

The QBI deduction for specified service trades or businesses (SSTBs) begins phasing out when taxable income exceeds \$191,950 for single filers (\$383,900 for married filing jointly) in 2024. These thresholds are adjusted annually for inflation. Within the phase-out range, the SSTB deduction is proportionally reduced. Above the upper limit (\$241,950 single, \$483,900 MFJ), no QBI deduction is available for SSTBs. Non-SSTBs don't face this phase-out but have W-2 wage limitations.

**23. Correct Answer: A (\$191,950 single)**

The W-2 wage limitation for the QBI deduction applies when taxable income exceeds \$191,950 for single filers (\$383,900 for married filing jointly) in 2024. Below these thresholds, taxpayers can claim the full 20% of QBI without wage or property limitations. Above these thresholds, the deduction is limited to the greater of (1) 50% of W-2 wages, or (2) 25% of W-2 wages plus 2.5% of the unadjusted basis of qualified property. This ensures the deduction benefits businesses that employ workers or invest in property.

**24. Correct Answer: D (2.5% of property)**

The QBI deduction above the income thresholds is limited to the greater of: (1) 50% of W-2 wages paid by the business, or (2) 25% of W-2 wages plus 2.5% of the unadjusted basis immediately after acquisition (UBIA) of qualified property. The alternative calculation (25% wages + 2.5% property) benefits capital-intensive businesses with significant equipment or real estate but lower wage payments. Qualified property must be tangible, depreciable, and used in producing QBI.

**25. Correct Answer: C (Consulting)**

Specified service trades or businesses (SSTBs) include those involving services in health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, investing and investment management, trading, and businesses where the principal asset is the reputation or skill of one or more owners or employees. Engineering and architecture are specifically excluded from SSTB treatment by statute.

**26. Correct Answer: D (After AGI)**

The QBI deduction is taken "below the line"—after adjusted gross income is calculated and after the deduction for one-half of self-employment tax. It's a deduction from AGI, not a deduction in computing AGI (above-the-line). The QBI deduction is calculated on the qualified business income after deducting one-half of self-employment tax. It reduces taxable income but not AGI or self-employment tax.

**27. Correct Answer: D (50% or more)**

Aggregation of multiple businesses for QBI purposes requires common ownership of 50% or more of each business (directly or through attribution), and the businesses must satisfy at least two of five factors: provide products/services, share facilities, share centralized business functions, operate in coordination or reliance, or have shared functions. Aggregation can help businesses meet the W-2 wage limitation and simplify calculations.

**28. Correct Answer: A (QBI)**

Qualified property for QBI purposes is tangible depreciable property owned by the business and used in the production of qualified business income during the tax year, with the depreciable period not having ended before the close of the tax year. Land is not qualified property because it's not depreciable. The unadjusted basis immediately after acquisition (before any depreciation) is used in the calculation.

**29. Correct Answer: B (Reasonable compensation)**

QBI does not include reasonable compensation paid to S corporation shareholder-employees, guaranteed payments for services paid to partners, or income that is not effectively connected with a U.S. trade or business. QBI includes the net income from qualified trades or businesses, which can include partnership distributive share income, S corporation pass-through income, and sole proprietor Schedule C income. Capital gains, dividends, and interest are generally excluded.

**30. Correct Answer: C (20%)**

Qualified REIT dividends and qualified publicly traded partnership (PTP) income are eligible for a 20% deduction under Section 199A, separate from the QBI deduction for operating businesses. This deduction applies to ordinary REIT dividends (not capital gain distributions) and PTP income. The deduction is subject to the overall taxable income limitation but not the W-2 wage or UBIA limitations that apply to operating businesses.

**31. Correct Answer: D (20%)**

Qualified publicly traded partnership (PTP) income qualifies for a 20% Section 199A deduction, similar to REIT dividends. PTPs are partnerships traded on established securities markets or readily tradable on secondary markets. The deduction applies to the partner's allocable share of

qualified PTP income. This deduction is combined with other Section 199A components and is subject to the taxable income limitation.

**32. Correct Answer: A (20% of taxable income)**

The combined Section 199A deduction cannot exceed 20% of the taxpayer's taxable income minus net capital gain. This overall limitation prevents the QBI deduction from creating or increasing losses. The calculation involves determining the deduction separately for each business, applying SSTB and wage/property limitations, then combining all components and applying the overall taxable income limit.

**33. Correct Answer: C (Qualified payments)**

Agricultural and horticultural cooperatives provide Section 199A deductions to their patrons on qualified payments (QPS—qualified payments from cooperatives) received from the cooperative. The patron can deduct the lesser of (1) 20% of QPS, or (2) 50% of W-2 wages with respect to the QPS or the alternative wage/property calculation. This allows cooperative patrons to benefit from Section 199A on income passed through from cooperatives.

**34. Correct Answer: B (9%)**

Agricultural and horticultural cooperatives themselves can claim a Section 199A(g) deduction equal to 9% of the lesser of qualified production activities income or taxable income. This is similar to the old domestic production activities deduction and recognizes the cooperative structure. The cooperative passes through information to patrons about qualified payments, allowing both the cooperative and patrons to benefit from Section 199A.

**35. Correct Answer: C (250+ hours and records)**

Rental real estate can be treated as a trade or business for QBI purposes if the rental activity meets requirements including maintaining contemporaneous records and performing 250 or more hours of rental services annually. This safe harbor, provided in Revenue Procedure 2019-38, allows rental real estate to qualify for the QBI deduction. Without meeting the safe harbor, taxpayers must show rental activities constitute a trade or business under Section 162.

**36. Correct Answer: D (250 hours)**

The safe harbor for rental real estate to qualify as a trade or business for QBI purposes requires 250 or more hours of rental services per year. Rental services include advertising, negotiating leases, collecting rent, repairs and maintenance, purchasing materials, and supervising employees and contractors. The taxpayer must maintain contemporaneous records documenting hours. Triple net leases generally don't qualify because few services are provided.

**37. Correct Answer: C (Trade or business)**

Triple net leases (where the tenant pays property taxes, insurance, and maintenance) generally don't qualify as a trade or business for QBI purposes because the landlord provides minimal services. The rental is more like a passive investment. Without qualifying as a trade or business under Section 162 or meeting the safe harbor requirements, rental income from triple net leases doesn't generate QBI eligible for the Section 199A deduction.

**38. Correct Answer: A (Carryforward loss)**

QBI losses from one qualified business offset QBI income from other businesses in the current year. If total QBI is negative (aggregate loss), the loss is treated as a loss from a qualified business in the following year, reducing next year's QBI. This QBI loss carryforward continues until offset by future QBI. The carryforward is tracked separately and offsets future QBI before applying the 20% deduction.

**39. Correct Answer: D (Original cost)**

Unadjusted basis immediately after acquisition (UBIA) for qualified property means the original cost of the property without reduction for depreciation. This amount is used in calculating the alternative W-2 wage limitation (25% of W-2 wages plus 2.5% of UBIA of qualified property). Using unadjusted basis rather than depreciated basis provides a larger deduction limitation for businesses with significant property investments.

**40. Correct Answer: D (No deduction)**

For short tax years (less than 12 months), special rules apply for calculating the QBI deduction. The calculation generally requires annualization of income and deductions, and the thresholds for wage and SSTB limitations must be prorated based on the number of months in the short year. Short years can occur in the first or last year of business operations or when changing tax years.

**41. Correct Answer: A (No limitation)**

Trusts and estates can claim the QBI deduction and are subject to similar rules as individuals, not "no limitation." They calculate the deduction at the entity level and can pass through QBI, W-2 wages, and UBIA of qualified property to beneficiaries. The income thresholds for wage/UBIA limitations and SSTB phase-outs are adjusted for trusts and estates (compressed tax brackets). This ensures the deduction is available to businesses operated through estates and trusts.

**42. Correct Answer: C (Partially included)**

QBI generally includes only income effectively connected with a U.S. trade or business. Puerto Rico source income can be QBI if it's from a U.S. trade or business, but special rules may apply. The determination depends on whether the income is effectively connected with a U.S. trade or business. Income that is not effectively connected or is foreign-source income generally doesn't qualify as QBI.

**43. Correct Answer: B (\$305,000 single)**

The excess business loss limitation for 2024 is approximately \$305,000 for single filers and \$610,000 for married filing jointly (adjusted annually for inflation). Business losses exceeding these amounts cannot offset non-business income (wages, investment income) in the current year. The excess loss is treated as a net operating loss (NOL) carryforward to future years. This limitation prevents high earners from using business losses to shelter other income.

**44. Correct Answer: D (NOL carryforward)**

Excess business losses (business losses exceeding the threshold amounts) are treated as net operating loss (NOL) carryforwards to subsequent years. They're not lost—they're deferred until future years when they can offset up to 80% of taxable income. The NOL carryforward is indefinite (can be carried forward indefinitely) but cannot offset more than 80% of income in any carryforward year.

**45. Correct Answer: B (At-risk and passive loss rules)**

The excess business loss limitation is applied after the at-risk limitations and passive activity loss rules. The order of limitations is: (1) basis limitation, (2) at-risk limitation, (3) passive activity loss limitation, and (4) excess business loss limitation. Only after passing through these other limitations can business losses be subject to the excess business loss limit. This layered approach ensures proper limitation of losses.

**46. Correct Answer: A (Partnership agreement)**

A partner's distributive share of partnership income, gains, losses, deductions, and credits is determined by the partnership agreement (written or oral), provided the allocations have substantial economic effect. If the partnership agreement doesn't specify allocations or they lack substantial economic effect, allocations must be made in accordance with the partner's interest in the partnership, determined by all facts and circumstances.

**47. Correct Answer: D (Ordinary income)**

Guaranteed payments to partners are payments made without regard to partnership income, typically for services or use of capital. They're deductible by the partnership (or capitalized if for property acquisition) and taxable to the partner as ordinary income. Guaranteed payments are reported separately on Schedule K-1 and treated as ordinary income to the partner, regardless of the partnership's overall profit or loss.

**48. Correct Answer: B (Liabilities)**

A partner's basis in their partnership interest increases by their share of partnership income (separately stated and non-separately stated), tax-exempt income received by the partnership, and increases in the partner's share of partnership liabilities. Distributions received, losses and deductions allocated to the partner, non-deductible expenses, and decreases in partnership

liabilities reduce basis. Proper basis tracking is critical for determining loss limitations and tax consequences of distributions.

**49. Correct Answer: C (Basis)**

Partnership distributions reduce the partner's basis in their partnership interest. Distributions are generally tax-free to the extent of basis. If a distribution of money exceeds the partner's basis, the excess is taxable as gain (usually capital gain). Property distributions generally don't trigger gain unless the partner's basis is reduced below zero. The partner takes a carryover basis in distributed property, subject to limitations.

**50. Correct Answer: A (Basis)**

Liquidating distributions (distributions in complete termination of a partner's interest) are taxable to the extent cash distributions exceed the partner's basis in the partnership interest. The excess is capital gain. If only property (no cash) is distributed, no gain is recognized. If cash received is less than basis, the partner recognizes capital loss only if the distribution consists solely of cash, unrealized receivables, and inventory. Loss recognition is limited to prevent tax-motivated distributions.

**51. Correct Answer: D (Inventory)**

Hot assets under Section 751 include unrealized receivables (for cash-method taxpayers) and inventory items substantially appreciated in value (FMV exceeds 120% of adjusted basis). Unrealized receivables include rights to payment for goods or services not previously included in income and recapture income. When hot assets are present, portions of partnership distributions or sales of partnership interests create ordinary income rather than capital gain.

**52. Correct Answer: B (Distributions and sales)**

Section 751 property (hot assets) creates ordinary income when: (1) a partner sells or exchanges a partnership interest (gain attributable to hot assets is ordinary income), or (2) a partnership distributes hot assets in a non-pro rata manner (creating ordinary income on the deemed exchange). This prevents partners from converting ordinary income into capital gain through distributions or sales.

**53. Correct Answer: A (Purchase price)**

When a partnership interest is purchased, the buyer's outside basis (basis in the partnership interest) equals the purchase price paid plus the buyer's share of partnership liabilities. The buyer's inside basis (share of partnership assets) initially equals the seller's share unless the partnership has a Section 754 election in effect, which allows basis adjustment under Section 743(b) to equalize inside and outside basis.

**54. Correct Answer: C (Outside basis)**

A Section 754 election allows partnerships to adjust inside basis (basis in partnership assets allocable to a partner) to equal outside basis (the partner's basis in their partnership interest) when partnership interests are transferred or distributions occur. The election prevents disparities between inside and outside basis that can create phantom income or losses. Section 743(b) adjustments apply to transfers; Section 734(b) adjustments apply to distributions.

**55. Correct Answer: D (Transferee partner)**

Section 743(b) basis adjustment (when a Section 754 election is in effect) benefits the transferee partner who purchased the partnership interest. The adjustment is a special basis adjustment that applies only to the transferee partner, not to other partners. It adjusts the transferee's share of inside basis in partnership assets to match the price paid for the interest, preventing double taxation or double deduction.

**56. Correct Answer: B (General partners)**

Partnership self-employment income includes the general partner's distributive share of partnership income from a trade or business, regardless of whether the income is distributed. Limited partners' distributive shares are generally not subject to self-employment tax (except for guaranteed payments for services). This distinction reflects general partners' active role in management versus limited partners' passive investor role.

**57. Correct Answer: C (Self-employment tax)**

Guaranteed payments for services to partners are subject to self-employment tax, whether paid to general or limited partners. The payments are treated like wages for self-employment tax purposes but not for FICA withholding purposes (no withholding required). Guaranteed payments for use of capital are not subject to self-employment tax. The self-employment tax treatment recognizes that guaranteed payments for services replace wage income.

**58. Correct Answer: A (Material income-producing factor)**

Family partnerships are respected for tax purposes only if capital is a material income-producing factor in the business, or if family members contribute substantial or vital services. If capital is material, family members can receive allocations of partnership income attributable to their capital contributions. Services must be genuine and adequately compensated before income can be allocated to family members who contributed capital.

**59. Correct Answer: D (Basis)**

Partnership minimum gain prevents partners from receiving distributions that reduce their basis below zero. Minimum gain is the amount of gain that would be recognized if the partnership disposed of property subject to nonrecourse debt for no consideration other than relief from the debt. Distributions cannot reduce a partner's basis below their share of minimum gain, ensuring partners remain at risk for their share of nonrecourse debt.

**60. Correct Answer: B (Partnership)**

Multi-member LLCs are classified by default as partnerships for federal tax purposes unless they elect corporate treatment. This provides liability protection with pass-through taxation. LLCs combine the legal advantages of corporations (limited liability) with the tax advantages of partnerships (single level of taxation, basis for debt, flexibility in allocations). LLCs can elect corporate treatment by filing Form 8832.

**61. Correct Answer: A (Disregarded entity)**

Single-member LLCs are treated by default as disregarded entities for federal tax purposes—their income and expenses are reported directly on the owner's return (Schedule C for businesses, Schedule E for rentals). The LLC provides liability protection but has no separate tax existence. Single-member LLCs can elect to be taxed as corporations, which creates a separate tax entity.

**62. Correct Answer: C (Corporation)**

The check-the-box regulations (Form 8832) allow eligible entities including LLCs to elect their tax classification. Multi-member LLCs can elect to be taxed as corporations (C or S corporation). Single-member LLCs can elect corporate treatment. This flexibility allows entities to choose the tax regime that best fits their business needs while maintaining their legal structure.

**63. Correct Answer: D (Individuals, estates, certain trusts)**

S corporation shareholders must be individuals who are U.S. citizens or residents, estates, certain trusts (grantor trusts, testamentary trusts, qualified Subchapter S trusts, electing small business trusts), or certain tax-exempt organizations (401(k) plans, charitable organizations). Corporations, partnerships, nonresident aliens, and most trusts cannot be S corporation shareholders. These restrictions maintain the small, closely-held nature of S corporations.

**64. Correct Answer: B (100 shareholders)**

S corporations can have a maximum of 100 shareholders. A family (up to 6 generations from the youngest generation) can elect to be treated as one shareholder. Spouses automatically count as one shareholder. This limit distinguishes S corporations from publicly traded C corporations and ensures they remain closely held. Exceeding 100 shareholders terminates the S election.

**65. Correct Answer: C (Not permitted)**

S corporations cannot have nonresident alien shareholders. All shareholders must be U.S. citizens or residents, or eligible trusts or estates. If a nonresident alien acquires S corporation stock, the S election immediately terminates. This restriction ensures S corporation income is subject to U.S. taxation. Resident aliens (green card holders or meeting substantial presence test) can be shareholders.

**66. Correct Answer: D (Required year or Section 444)**

S corporations must generally use the calendar year (required year), unless they can establish a business purpose for a different fiscal year or make a Section 444 election for a fiscal year with a deferral of 3 months or less. The calendar year requirement simplifies administration and prevents deferral of income. Section 444 elections require required payments to offset the tax benefit of deferral.

**67. Correct Answer: B (5 years)**

The S corporation built-in gains tax recognition period is 5 years (reduced from 10 years). When a C corporation converts to an S corporation, appreciation in assets at the conversion date is subject to corporate-level tax if recognized within 5 years. The tax rate is 21% on recognized built-in gains. This prevents C corporations from converting to S status solely to avoid corporate tax on appreciated assets.

**68. Correct Answer: D (Accumulated adjustments)**

The Accumulated Adjustments Account (AAA) for S corporations tracks post-S-election income and losses, minus distributions. It represents earnings that have been taxed to shareholders but not yet distributed. Distributions are deemed to come first from AAA (tax-free return of basis), then from accumulated earnings and profits from C corporation years (taxable dividends), then as return of stock basis, and finally as capital gain.

**69. Correct Answer: A (AAA)**

S corporation distributions are deemed to come first from AAA (Accumulated Adjustments Account), which makes them tax-free reductions of stock basis. Only after AAA is exhausted do distributions potentially come from accumulated E&P (if the corporation was previously a C corporation), creating dividend income. Then distributions reduce stock basis, and finally create capital gain if basis is zero.

**70. Correct Answer: C (Direct loans only)**

S corporation shareholder basis includes stock basis (capital contributions plus/minus income and losses) plus debt basis (direct loans from the shareholder to the corporation). Unlike partnerships, S corporation entity liabilities don't increase shareholder basis. Only direct shareholder loans create debt basis. Guarantees of corporate debt don't create basis. This limitation makes S corporation loss deductions more restrictive than partnership losses.

**71. Correct Answer: D (100% of another corporation)**

A qualified subchapter S subsidiary (QSub) election allows an S corporation to own 100% of another corporation's stock and treat it as a division rather than a separate corporation. The subsidiary's assets, liabilities, income, and deductions are treated as belonging to the parent S corporation. This allows affiliated S corporation groups while maintaining S status. Only 100% owned subsidiaries can be QSubs.

**72. Correct Answer: B (1 year)**

The post-termination transition period for S corporations is generally the later of: (1) 1 year after the last day of the final S corporation year, (2) the due date for the final S return (including extensions), or (3) 120 days after a determination that the S election terminated in a prior year. During this period, shareholders can use suspended losses against distributions (to the extent of stock basis).

**73. Correct Answer: D (Voting rights permitted)**

S corporations can have only one class of stock, meaning all outstanding shares must confer identical rights to distribution and liquidation proceeds. However, differences in voting rights are permitted and don't create a second class of stock. Common and preferred stock with different dividend or liquidation rights would violate the one-class rule and terminate the S election.

**74. Correct Answer: A (2553)**

The S corporation election is made on Form 2553, Election by a Small Business Corporation. The form requires consent signatures from all shareholders and must be filed by the 15th day of the third month of the tax year (March 15 for calendar year corporations) to be effective for that year. Late elections are effective for the following year unless the IRS grants relief for reasonable cause.

**75. Correct Answer: D (21%)**

C corporations pay tax at a flat rate of 21% on taxable income, as enacted by the Tax Cuts and Jobs Act. This replaced the previous graduated rate structure. The flat rate simplifies calculation and makes U.S. corporate rates more competitive internationally. The 21% rate applies to all levels of corporate income without graduation or surtax.

**76. Correct Answer: B (65%)**

The dividends received deduction for corporations owning 20% or more (but less than 80%) of another corporation's stock is 65% of dividends received. This partially mitigates double taxation as income passes through corporate chains. For ownership under 20%, the DRD is 50%. For 80% or more ownership, the DRD is 100%. These rules prevent income from being fully taxed at each corporate level.

**77. Correct Answer: C (50%)**

The dividends received deduction for corporations owning less than 20% of the paying corporation's stock is 50% of dividends received. This means 50% of the dividend is excluded from income, while 50% is taxable. The DRD prevents complete triple taxation but ensures some tax is paid at each level. The deduction may be limited if it creates or increases a net operating loss.

**78. Correct Answer: A (Capital gains only)**

Corporate capital losses can only offset capital gains—they cannot offset ordinary income at all, unlike individuals who can deduct \$3,000 annually against ordinary income. This makes capital losses less valuable for corporations. The limitation encourages corporations to carefully manage capital asset transactions and timing to maximize tax benefit of capital losses.

**79. Correct Answer: D (3 years)**

Corporate capital losses can be carried back 3 years (applied to the three preceding years, earliest first) and carried forward 5 years, providing an 8-year window to use the losses. Capital loss carrybacks can create refund claims for prior year taxes. Carryforwards and carrybacks retain their character as capital losses and can only offset capital gains.

**80. Correct Answer: B (10%)**

Corporate charitable contribution deductions are limited to 10% of taxable income (computed before the charitable deduction, dividends received deduction, capital loss carryback, and domestic production activities deduction). Contributions exceeding the limit carry forward 5 years. The computation is more complex than the individual limit and often requires iterations to determine the exact limitation.

**81. Correct Answer: A (20%)**

The accumulated earnings tax is imposed at 20% on accumulated taxable income. This penalty tax applies to corporations formed or availed of to avoid shareholder income tax by accumulating earnings beyond reasonable business needs. The tax is in addition to regular corporate income tax. Accumulated earnings of \$250,000 (manufacturing) or \$150,000 (other corporations) are generally considered reasonable without specific showing of business need.

**82. Correct Answer: C (Accumulated earnings tax)**

Demonstrating reasonable accumulation for business needs avoids the accumulated earnings tax. Reasonable needs include specific, definite, and feasible plans for business expansion, debt retirement, working capital requirements, investments or loans to suppliers or customers, or realistic threat of business loss. General, unplanned accumulations for unspecified future needs don't avoid the tax.

**83. Correct Answer: D (60%)**

The personal holding company tax applies when 60% or more of adjusted ordinary gross income consists of personal holding company income (dividends, interest, rents, royalties, certain personal service income). Combined with the ownership test (more than 50% of stock value owned by 5 or fewer individuals), corporations meeting both tests pay PHC tax on undistributed personal holding company income. The tax is 20%.

**84. Correct Answer: B (Taxable income)**

Schedule M-1 of Form 1120 reconciles book income (financial statement income) to taxable income. It identifies items treated differently for book and tax purposes, such as tax-exempt interest (book income but not taxable), nondeductible expenses (book expense but not tax deductible), and timing differences. The reconciliation ensures the IRS can understand differences between financial and tax reporting.

**85. Correct Answer: C (\$10 million)**

Schedule M-3 is required for corporations with total assets of \$10 million or more (reporting corporations). Schedule M-3 provides a more detailed reconciliation of net income per books with taxable income than Schedule M-1. It separates temporary and permanent differences and provides greater transparency for the IRS. The detailed format improves IRS examination efficiency and taxpayer compliance.

**86. Correct Answer: A (\$50,000)**

Organizational costs can be deducted up to \$5,000 in the year business begins, but this amount is reduced dollar-for-dollar when total organizational costs exceed \$50,000. If costs exceed \$55,000, the entire \$5,000 deduction is eliminated and all costs are amortized over 180 months. Organizational costs include legal fees, state incorporation fees, and costs of organizational meetings.

**87. Correct Answer: D (180 months)**

Organizational costs exceeding the \$5,000 first-year deduction are amortized over 180 months (15 years), beginning with the month the corporation begins business. The same treatment applies to partnership organizational costs and startup costs. The lengthy amortization period reflects the indefinite benefit period of organizational expenditures that benefit the entire existence of the entity.

**88. Correct Answer: B (Disallowed)**

Losses on sales or exchanges between a corporation and a shareholder owning more than 50% of the corporation's stock are disallowed under related party loss rules. The loss is permanently disallowed to the seller. If the related purchaser later sells the property at a gain to an unrelated party, the previously disallowed loss can offset the gain (but can't create or increase a loss). This prevents tax-motivated loss sales within related groups.

**89. Correct Answer: A (Spouse and children)**

Constructive ownership rules attribute stock ownership among family members including spouses, children, grandchildren, and parents. Brothers and sisters are not included in family attribution (though they're related parties for other purposes). The rules also attribute stock from entities (corporations, partnerships, trusts, estates) to owners based on ownership percentages. Attribution rules determine related party status for various tax provisions.

**90. Correct Answer: C (Multiple tax benefits)**

Controlled group rules prevent multiple corporations under common control from claiming multiple tax benefits that should be available only once. Benefits subject to controlled group limitations include Section 179 expensing limits, accumulated earnings tax credits, and alternative minimum tax exemptions (when AMT existed). Controlled groups must share these benefits as if they were one corporation.

**91. Correct Answer: D (50%)**

A brother-sister controlled group exists when five or fewer individuals, estates, or trusts own more than 50% of the voting power or value of stock in each corporation (with at least 80% common ownership counted identically). The 50% test ensures the same people control the corporations. The rules have two separate tests that must both be met for brother-sister status. Controlled group members share certain tax benefits.

**92. Correct Answer: B (80% or more)**

A parent-subsidiary controlled group exists when one corporation owns stock possessing 80% or more of voting power or value of another corporation. Chains of corporations can create controlled groups if 80% ownership exists at each level. The 80% threshold is lower than the 100% required for consolidated returns, allowing controlled group treatment without consolidation eligibility.

**93. Correct Answer: C (Consolidated returns)**

Affiliated groups of corporations (generally requiring 80% ownership) can elect to file consolidated returns, combining income and losses of group members into a single return. Consolidation allows offsetting of income and losses among group members, elimination of intercompany transactions, and other benefits. However, separate entity records must be maintained, and complex regulations govern consolidated return filing.

**94. Correct Answer: A (1502)**

Consolidated return regulations are issued under Internal Revenue Code Section 1502, which grants the Treasury broad authority to prescribe regulations for consolidated returns. The regulations are extensive and complex, covering topics including eligibility, intercompany transactions, limitations on attributes, and apportionment of tax liability. The regulations have the force of law despite not being in the statute.

**95. Correct Answer: D (Deferred)**

Intercompany transactions in consolidated groups are generally deferred—gains or losses on transactions between group members are not recognized immediately but are deferred until a triggering event occurs (such as sale to a party outside the group or member leaving the group). This matching rule prevents income recognition on transactions that are economically transfers within a single economic unit.

**96. Correct Answer: C (Group members)**

In a consolidated group, net operating losses can offset income of other group members in the consolidated return. This is a primary benefit of consolidation—losses of one member reduce the group's overall tax liability. However, built-in losses and other attributes are subject to limitations to prevent trafficking in losses through group restructuring.

**97. Correct Answer: A (Nonrefundable)**

The minimum tax credit for prior year alternative minimum tax is a nonrefundable credit. The prior system (before corporate AMT repeal) allowed corporations to carry forward AMT credits indefinitely to offset regular tax, but not below tentative minimum tax. After TCJA repealed corporate AMT, unused credits became refundable over several years (2018-2021). For individuals, the credit remains nonrefundable with indefinite carryforward.

**98. Correct Answer: C (Indefinite)**

Minimum tax credit carryforwards are indefinite—they don't expire. Unused credits can be carried forward to future years without limit. After the TCJA repealed corporate AMT, corporate AMT credits were made refundable through 2018-2021. Individual AMT credits can be carried forward indefinitely to offset regular tax in excess of tentative minimum tax.

**99. Correct Answer: D (1 year)**

The research credit is part of the general business credit and has a 1-year carryback and 20-year carryforward under current law. The carryback allows taxpayers to claim refunds for prior year taxes. However, many general business credits no longer have carryback periods after the Tax Cuts and Jobs Act, depending on when the credits were generated. The research credit encourages innovation through tax incentives.

**100. Correct Answer: B (State workforce agency)**

The Work Opportunity Tax Credit requires certification by the state workforce agency (or designated local agency) that the employee is a member of a targeted group facing employment barriers. Form 8850 must be filed with the agency within 28 days of employment. Without timely certification, the credit is not available even if the employee is actually a targeted group member. The certification requirement ensures credits are properly claimed.

## **Part 3: Representation, Practices, And Procedures**

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**1. Correct Answer: C (Code of Federal Regulations)**

Circular 230, Regulations Governing Practice Before the Internal Revenue Service, is found in Title 31, Part 10 of the Code of Federal Regulations (31 C.F.R. Part 10). While the substantive tax law is in the Internal Revenue Code (Title 26), Circular 230 governs the conduct and duties of

practitioners representing taxpayers before the IRS. The regulations have the force of law and violations can result in discipline including censure, suspension, or disbarment.

## **2. Correct Answer: A (IRS)**

Enrolled agents are enrolled to practice before the Internal Revenue Service, not all federal agencies, Tax Court, or state agencies. However, practicing "before the IRS" includes representing taxpayers in audits, collections, appeals, and preparing and filing returns. Enrolled agents, attorneys, and CPAs all have unlimited practice rights before the IRS. The enrollment is granted by the IRS after passing the Special Enrollment Examination or having qualifying IRS experience.

## **3. Correct Answer: D (Any U.S. jurisdiction)**

Attorneys must be licensed and in good standing to practice law in any U.S. state, territory, possession, or the District of Columbia. They don't need to be licensed in the state where they're representing a taxpayer before the IRS—any U.S. jurisdiction suffices. However, they must not be under suspension or disbarment from practice before the IRS. Active license and good standing must be maintained.

## **4. Correct Answer: B (State board)**

CPAs must hold a valid, active license from a state board of accountancy and must be in good standing. Like attorneys, CPAs licensed in any U.S. state or jurisdiction can practice before the IRS nationally. They must comply with CPE requirements of their licensing state and must not be under suspension or disbarment from IRS practice. The CPA license is the key credential, not membership in professional organizations.

## **5. Correct Answer: C (Pension plans)**

Enrolled actuaries can represent clients before the IRS on matters related to employee retirement plans under ERISA (Employee Retirement Income Security Act). Their practice is limited to actuarial matters involving plans they're enrolled to practice before the Joint Board for the Enrollment of Actuaries. They cannot represent clients on income tax returns or other tax matters outside pension and retirement plan issues.

## **6. Correct Answer: A (Eliminated)**

The registered tax return preparer program, which would have required testing and continuing education for all paid preparers, was eliminated after courts ruled the IRS lacked statutory authority to regulate return preparers beyond those specifically authorized by Congress. Currently, the IRS can regulate enrolled agents, attorneys, CPAs, and enrolled retirement plan agents, but cannot require registration of unenrolled preparers beyond obtaining PTINs.

## **7. Correct Answer: D (Disbarment)**

Circular 230 sanctions for practitioner misconduct include censure (public or private reprimand), suspension from practice before the IRS for a specified period, and disbarment (indefinite prohibition from practice unless successfully petitioning for reinstatement). Monetary penalties can also be imposed. These sanctions are administrative actions taken by the IRS Office of Professional Responsibility, separate from any criminal penalties or state licensing discipline.

**8. Correct Answer: C (Professional Responsibility)**

The Office of Professional Responsibility (OPR) is the IRS office responsible for enforcing Circular 230 and administering the discipline system for practitioners. OPR investigates complaints of practitioner misconduct, prosecutes disciplinary cases, and issues sanctions. The office operates independently within the IRS to ensure fair and objective enforcement of professional standards for tax practitioners.

**9. Correct Answer: B (Noncompliance or errors)**

Practitioners must promptly advise clients of noncompliance, errors, or omissions discovered on returns or other documents submitted to the IRS. The duty runs to the client, not the IRS—practitioners don't report client errors to the IRS. The practitioner informs the client of the consequences of noncompliance and advises on corrective action. This duty protects clients while maintaining professional standards.

**10. Correct Answer: A (With client consent)**

Confidential client information can be disclosed with the client's informed written consent, pursuant to court orders, to comply with Circular 230 or other applicable laws, or for limited purposes such as quality or peer reviews, criminal investigations, or conflicts checks. Practitioners cannot disclose client information for marketing or other unauthorized purposes. Client confidentiality is a core professional obligation.

**11. Correct Answer: D (Informed consent)**

Conflicts of interest require informed written consent from all affected clients. The practitioner must disclose the conflict, explain its implications, and obtain consent to continue representation despite the conflict. If the conflict is so severe that consent cannot cure it (such as direct adversity in the same proceeding), the practitioner must decline or withdraw from representation. Conflicts rules protect client interests and prevent divided loyalties.

**12. Correct Answer: B (When requested)**

Under Circular 230 Section 10.28, practitioners must return client records promptly upon request, regardless of fees owed. "Client records" include documents originally provided by the client and records necessary for the client to comply with federal tax obligations. The practitioner cannot delay return until after 3 years, after payment, or at their discretion—the requirement is immediate

upon request. This ensures clients can meet tax obligations and obtain other representation even when fee disputes exist.

**13. Correct Answer: B (Examination or refund claims)**

Contingent fees are generally prohibited under Circular 230 but are permitted for services in connection with IRS examinations or audits of original returns, claims for refund or credit (except for preparing original returns), and judicial proceedings. The exception recognizes that these services involve disputes over existing liabilities where contingency arrangements are appropriate. Preparing original returns for contingent fees is prohibited.

**14. Correct Answer: D (More likely than not)**

Standards for tax returns under Circular 230 Section 10.34 prohibit practitioners from advising clients to take positions or preparing returns that lack substantial authority, unless the position has reasonable basis and is adequately disclosed. The standard is not "more likely than not" (which would be >50%). Substantial authority is approximately 40% likelihood, reasonable basis approximately 20%. Disclosure protects against accuracy-related penalties for positions with reasonable basis.

**15. Correct Answer: A (Relevant facts)**

Written tax advice standards under Circular 230 Section 10.37 require practitioners to base advice on reasonable factual and legal assumptions, reasonably consider all relevant facts and law, use reasonable efforts to identify facts, not rely on unreasonable factual or legal assumptions, and relate applicable law to facts. These requirements ensure advice is grounded in actual facts and proper legal analysis, not wishful thinking.

**16. Correct Answer: C (10.37)**

Covered opinions (opinions on listed transactions, significant purpose transactions, and certain other tax-motivated transactions) require compliance with Circular 230 Section 10.35, which imposes heightened standards including thorough factual investigation, consideration of all relevant facts, and analysis of all significant federal tax issues. Section 10.37 covers general written advice. Section 10.36 covers procedures to ensure compliance. The heightened standards for covered opinions reflect their potential for abuse.

**17. Correct Answer: B (All significant issues)**

Tax shelter opinions and covered opinions must comprehensively address all significant federal tax issues, reach conclusions on each issue, and provide overall conclusions. The opinion cannot be hedged, qualified, or limited in ways that leave significant issues unresolved. This comprehensive requirement ensures clients receive complete analysis, not selective advice that ignores unfavorable authorities or issues.

**18. Correct Answer: D (Written consent)**

Practitioners may not represent conflicting interests without informed written consent from all affected clients. The consent must be in writing (not verbal or implied) and clients must be informed of the conflict, potential adverse effects, and alternatives. If conflicts are too severe (direct adversity in the same proceeding), consent cannot cure them and the practitioner must decline or withdraw. IRS approval, waivers, or court orders are not required—written client consent is the key requirement.

**19. Correct Answer: A (Engagement)**

Under Circular 230 and professional best practices, fee information should be furnished in writing if requested before the engagement begins. While Circular 230 Section 10.27 requires practitioners to provide fee information upon client request, it doesn't explicitly mandate written form in all cases. However, professional best practices strongly recommend providing clear, written fee information before starting work to prevent misunderstandings and disputes. Written fee agreements or engagement letters clarifying the fee structure (hourly, flat, contingent where permitted, or other arrangement) protect both the practitioner and client by establishing clear expectations from the outset. Providing this information before engagement allows clients to make informed decisions about retaining the practitioner.

**20. Correct Answer: C (Value billing)**

Practitioners cannot charge unconscionable fees or fees that are clearly excessive considering the time, difficulty, novelty, skill required, and customary charges for similar services. All fee arrangements are permitted if reasonable: hourly, flat fees, value billing, or contingent (where allowed). The prohibition is against excessive or unconscionable fees, not specific billing methods. Practitioners must communicate fee arrangements clearly.

**21. Correct Answer: B (Coercion)**

Solicitation is prohibited if it involves false or misleading communications, coercion, overreaching, or harassing conduct. Truthful advertising and solicitation are permitted. Practitioners can market their services and seek clients through advertising, networking, and targeted outreach, provided the communications are truthful and not coercive or harassing. Professional advertising must maintain dignity and accuracy.

**22. Correct Answer: B (Facts and circumstances)**

Best practices (Circular 230 Section 10.33) include communicating clearly with clients about the terms of engagement, establishing the facts and circumstances based on reasonable inquiry, advising clients of limitations on engagement scope, and identifying and resolving issues. These practices are aspirational guidelines for quality service, not enforceable standards. Following best practices protects both practitioners and clients.

**23. Correct Answer: B (Consult or study)**

A practitioner lacking competence in a matter can decline the engagement, become competent through study or research, associate with competent practitioners, or consult with experts. Lack of competence doesn't automatically require declining engagement—practitioners can educate themselves or obtain assistance. However, practitioners should not accept engagements beyond their capacity to competently complete, even with assistance.

**24. Correct Answer: B (Consequences of noncompliance)**

When a practitioner learns of client omissions or errors on returns or other documents, they must promptly advise the client of the noncompliance and the consequences of the noncompliance. The practitioner is not required to notify the IRS—the duty runs to the client. The practitioner should advise on corrective measures (amended returns, disclosure) but cannot file corrections without client authorization. The client decides whether to correct.

**25. Correct Answer: D (Questionable)**

Diligence requires practitioners to make reasonable inquiries when information appears to be incorrect, inconsistent, or incomplete. Practitioners cannot ignore obvious errors or red flags. However, they're not required to audit client records or independently verify every fact—reasonable reliance on client information is permitted absent reason to believe the information is questionable. The standard is reasonableness, not perfection.

**26. Correct Answer: D (Incorrect)**

Practitioners may rely on information provided by clients or third parties unless they know or should know the information is incorrect, incomplete, or inconsistent. This reasonable reliance standard balances efficiency (not requiring verification of every fact) with responsibility (investigating red flags). If information appears unreliable, further inquiry is required.

**27. Correct Answer: D (Substantive accuracy)**

The signing preparer must sign the return if they have primary responsibility for the overall substantive accuracy of the return. This is the person whose PTIN appears in the paid preparer section and who signs the return. There's only one signing preparer per return. Being responsible for a single position, filing the return, or just preparation assistance doesn't make someone the signing preparer—it's primary responsibility for overall accuracy that creates the signing preparer obligation.

**28. Correct Answer: A (Specific written authorization)**

Negotiating (endorsing) client refund checks requires specific written authorization from the client. General power of attorney (Form 2848) doesn't automatically authorize check negotiation—it requires explicit authorization. This protects clients by ensuring practitioners don't access client funds without clear permission. Many practitioners refuse to handle client checks to avoid potential liability and ethics issues.

**29. Correct Answer: B (Withdraw)**

If a practitioner knows the client intends not to comply with revenue laws or is counseling noncompliance, and the practitioner's advice is being used for improper purposes, the practitioner must withdraw from representation. Practitioners cannot continue representing clients in furtherance of violations. The practitioner is not required to report to the IRS—the remedy is withdrawal.

**30. Correct Answer: C (Quality)**

Advertising cannot make false, misleading, or deceptive statements, or make unverifiable claims about the quality of services. Claims about quality ("best," "premier," "leading") typically cannot be verified and may violate advertising standards. Factual statements about location, services offered, credentials, experience, and fees are permitted if truthful. Professional advertising must maintain accuracy and dignity.

**31. Correct Answer: C (Misleading)**

Practitioners must accurately state their names, credentials, and designations, and cannot use misleading titles or designations. Using credentials not actually held (CPA without a license) or misleading designations (implying expertise not possessed) violates Circular 230. Abbreviations are permitted if accurate. The key is truthfulness and accuracy in all professional designations and communications.

**32. Correct Answer: C (Government employee)**

Former government employees cannot represent clients on matters in which they personally and substantially participated as government employees. This "revolving door" restriction prevents conflicts of interest and protects government integrity. The restriction is permanent for matters personally handled. Former employees can represent clients on other matters not involving their personal substantial participation as government employees.

**33. Correct Answer: C (Representation)**

Practice before the IRS includes all matters connected with presentations to the IRS relating to a client's rights, privileges, or liabilities under laws or regulations administered by the IRS. This encompasses correspondence, representation during examinations, conferences, appeals, and other interactions. Mere administrative tasks like filing returns don't constitute practice, but representing taxpayer positions during disputes does.

**34. Correct Answer: B (Prepared and signed)**

Limited practice authority for unenrolled return preparers allows them to represent clients before revenue agents, customer service representatives, and similar IRS employees only on returns or claims for refund they personally prepared and signed. The representation is limited to these

specific returns and cannot extend to Appeals, Collection, or Tax Court. The preparer must have actually prepared and signed the return.

**35. Correct Answer: D (Perform acts)**

Form 2848 must include the matters and years for which representation is authorized. The authorization can be broad (all matters) or limited to specific issues or tax years. Practitioners should carefully review the scope of authority granted. The form doesn't authorize the representative to sign returns unless specifically stated, nor does it grant authority for matters or years not listed.

**36. Correct Answer: D (Perform acts)**

Form 2848, Power of Attorney and Declaration of Representative, authorizes the representative to represent the taxpayer before the IRS and perform acts specified on the form for the matters and tax years listed. This includes receiving confidential information, advocating positions, negotiating settlements, and generally acting on the taxpayer's behalf. The authority granted depends on what's specified on Form 2848.

**37. Correct Answer: C (Representation)**

Form 8821, Tax Information Authorization, allows designated individuals to inspect and receive confidential tax information for specified matters and years. It does NOT grant authority to represent the taxpayer, advocate positions, sign consents or agreements, or otherwise act on the taxpayer's behalf. It's purely an information disclosure authorization, useful for allowing accountants or family members to obtain tax information without representation authority.

**38. Correct Answer: B (Representative)**

The Centralized Authorization File (CAF) number is assigned to representatives, not taxpayers. Each practitioner receives a unique CAF number when first filed on a Form 2848. The CAF system allows the IRS to manage and track practitioner authorizations centrally. Practitioners provide their CAF number on subsequent Forms 2848, linking authorizations to their practitioner record.

**39. Correct Answer: C (3 years)**

Forms 2848 (Power of Attorney) are retained in the Centralized Authorization File for 3 years from the date recorded. After expiration, representatives must submit new Forms 2848 to represent taxpayers. The 3-year retention ensures current authorizations while requiring periodic updates. Taxpayers can check CAF status online and revoke authorizations at any time.

**40. Correct Answer: A (General authority)**

Powers of attorney can grant general authority for all matters or limited authority for specific matters or tax years. General authority allows representation on all tax matters for all years. Limited authority restricts representation to specified issues or periods. The scope should be

appropriate to the representation needs—unnecessarily broad authority should be avoided to protect client interests.

**41. Correct Answer: D (Sequential authority)**

Form 2848 allows appointment of multiple representatives who can act independently (either can act alone), jointly (all must act together), or in sequence (one acts unless unavailable). The default is independent authority—any appointed representative can act. Joint authority requires all representatives to agree. Sequential authority designates primary and backup representatives.

**42. Correct Answer: B (Written notice)**

Revocation of power of attorney requires the taxpayer to notify the IRS in writing. Filing a new Form 2848 for the same matters automatically revokes prior authorizations unless the retention box is checked. The taxpayer can also submit a written statement revoking specific Forms 2848. Representatives can also withdraw by notifying the IRS and the client in writing.

**43. Correct Answer: B (Authorized and eligible)**

The Declaration of Representative section of Form 2848 requires practitioners to declare under penalties of perjury that they're authorized to represent the taxpayer, currently eligible to practice before the IRS, and not under suspension or disbarment. This declaration protects the IRS and taxpayers by ensuring only authorized, eligible practitioners represent taxpayers.

**44. Correct Answer: C (Customer service and revenue agents)**

Unenrolled return preparers can appear only before customer service representatives, revenue agents, and similar IRS employees during examinations, and only regarding returns or claims they personally prepared and signed. They cannot represent clients before Appeals, revenue officers (Collection), or Tax Court. This limited practice authority recognizes preparers' familiarity with returns they prepared without granting full practice rights.

**45. Correct Answer: A (18 hours CE)**

The Annual Filing Season Program (AFSP) provides limited representation rights (similar to unenrolled preparers) for participants who complete 18 hours of continuing education annually, including 6 hours of federal tax law updates, 2 hours of ethics, and 10 hours of federal tax topics. AFSP participants receive a Record of Completion but not enrollment. The voluntary program encourages preparer education and competence.

**46. Correct Answer: C (3 years)**

Enrolled agents must complete 72 hours of continuing education every 3 years (an enrollment cycle), with a minimum of 16 hours per year including at least 2 hours of ethics annually. The requirement ensures EAs maintain current knowledge of tax law changes and professional

standards. Failure to meet CE requirements results in ineligibility for renewal and eventual termination of enrollment.

**47. Correct Answer: B (6 hours per cycle)**

The ethics continuing education requirement for enrolled agents is 2 hours per year, totaling 6 hours per 3-year enrollment cycle. Ethics CE ensures EAs understand professional responsibilities, Circular 230 requirements, and ethical obligations. The ethics requirement is in addition to federal tax law and other topic CE. Ethics courses must cover Circular 230 and professional conduct issues.

**48. Correct Answer: D (No carryforward)**

Continuing education hours exceeding the annual requirement (16 hours) cannot be carried forward to subsequent years. Each year stands alone—EAs must complete at least 16 hours annually regardless of prior year excess. However, hours can be accumulated across multiple courses within a year. The no-carryforward rule encourages consistent annual learning.

**49. Correct Answer: C (Every 3 years)**

The enrolled agent enrollment cycle is 3 years. Enrollment is renewed every 3 years upon demonstration of meeting continuing education requirements (72 hours total including 2 hours ethics annually). The cycle begins when initial enrollment is granted or renewed. EAs must complete Form 8554 to renew enrollment, certifying CE compliance and good standing.

**50. Correct Answer: C (Ineligibility for renewal)**

Failure to meet continuing education requirements results in ineligibility for enrollment renewal. The IRS will not renew enrollment for practitioners who haven't completed required CE. After expiration, former EAs cannot use the EA designation or represent clients before the IRS. Reinstatement requires completing missing CE hours plus current year requirements and may involve penalties.

**51. Correct Answer: A (8554)**

Enrolled agents renew their enrollment every 3 years by filing Form 8554, Application for Renewal of Enrollment to Practice Before the Internal Revenue Service. The form requires certifying completion of continuing education requirements (72 hours total including 6 hours of ethics over the 3-year cycle). Form 23 is the application for initial enrollment, Form 2848 is power of attorney, and Form 8821 is tax information authorization. Timely renewal maintains active enrollment status and practice rights.

**52. Correct Answer: C (80%)**

The Special Enrollment Examination (SEE) passing score is approximately 105-107 correct answers out of 130 scored questions (approximately 80%), though the exact scaled score required

may vary slightly by exam form due to equating. Each of the three parts contains 100 questions, but only 85-88 are scored (the rest are pretest questions). The exam uses scaled scoring to ensure consistent passing standards across different exam versions. The relatively high passing percentage reflects the professional competency required to practice before the IRS.

**53. Correct Answer: C (Separately scheduled)**

The Special Enrollment Examination consists of three parts—Part 1 (Individuals), Part 2 (Businesses), and Part 3 (Representation, Practices and Procedures)—that can be taken separately at different times. Candidates can schedule each part independently at Prometric testing centers and take them in any order. Candidates don't need to pass all three on the same day or consecutive days—they can spread testing over time based on their preparation and schedule. Each passed part remains valid, and candidates only need to retake failed parts.

**54. Correct Answer: C (5 years service)**

Former IRS employees can obtain enrollment without examination after 5 years of continuous service in a position regularly requiring application and interpretation of tax law. They must apply within 3 years of separation from IRS employment. This recognizes the expertise gained through IRS employment. The experience must involve substantive tax work, not clerical or administrative duties.

**55. Correct Answer: B (Employee plans)**

Enrolled retirement plan agents (ERPAs) can practice before the IRS on matters related to employee plans and exempt organizations under their jurisdiction under ERISA. Their practice is limited to Form 5500 series examinations and related matters. ERPAs cannot represent clients on income tax, estate tax, or other tax matters. This limited enrollment recognizes specialized expertise in retirement plan administration.

**56. Correct Answer: B (Until reinstated)**

Disbarment is an indefinite prohibition from practice before the IRS that continues until the practitioner is reinstated. While disbarment is the most serious Circular 230 sanction, it's not technically permanent—practitioners can petition for reinstatement after 5 years, though reinstatement is not guaranteed and requires demonstrating fitness to practice. Disbarment decisions are appealable to federal court. The indefinite nature (continuing until reinstated rather than having a set end date) distinguishes disbarment from suspension.

**57. Correct Answer: A (5 years)**

Practitioners disbarred from practice before the IRS can petition for reinstatement after 5 years from the effective date of disbarment. The petition must demonstrate rehabilitation, competence, fitness to practice, and compliance with all applicable laws. The IRS Office of Professional

Responsibility reviews reinstatement petitions. Reinstatement is not automatic—it requires showing worthiness to resume practice.

**58. Correct Answer: A (Specific period)**

Suspension from practice before the IRS is for a specific period of time determined by the IRS or Administrative Law Judge—such as 6 months, 1 year, 2 years, or other defined duration. After the suspension period ends, the practitioner can resume practice (assuming continuing education and other requirements are met). This differs from disbarment, which is indefinite and continues until reinstatement is granted. The defined, temporary nature of suspension makes it less severe than disbarment while still providing meaningful discipline for Circular 230 violations.

**59. Correct Answer: B (Minor violations)**

Censure is a public or private reprimand for violations of Circular 230. It's typically imposed for less serious violations that don't warrant suspension or disbarment. Censure serves as a warning and becomes part of the practitioner's record. Public censure is announced and may damage professional reputation. Private censure is communicated only to the practitioner but remains in OPR records.

**60. Correct Answer: C (Administrative Law Judge)**

Circular 230 disciplinary proceedings are conducted by Administrative Law Judges (ALJs). The Office of Professional Responsibility (OPR) investigates complaints and prosecutes cases, but formal hearings are held before ALJs who issue initial decisions. ALJs provide independent adjudication separate from OPR's prosecutorial role. The ALJ's decision can be appealed to the Treasury Secretary. This structure ensures due process with independent hearing officers deciding disciplinary cases.

**61. Correct Answer: A (30 days)**

In Circular 230 disciplinary proceedings, the practitioner must file an answer to the complaint within 30 days of service. The complaint is filed by OPR, and the practitioner's answer must respond to the allegations. Failure to timely answer can result in default judgment. The 30-day period balances providing adequate response time with moving proceedings forward expeditiously.

**62. Correct Answer: B (Treasury Secretary)**

Administrative Law Judge decisions in Circular 230 disciplinary proceedings can be appealed to the Treasury Secretary (or delegate). The Treasury Secretary reviews the ALJ's decision and issues a final agency decision. After exhausting this administrative review, practitioners can seek judicial review in federal district court. Tax Court, Appeals Office, and IRS Commissioner don't have authority over Circular 230 disciplinary appeals.

**63. Correct Answer: D (Convicted of crime)**

Expedited suspension procedures apply when a practitioner is convicted of certain crimes (tax crimes, crimes involving dishonesty or breach of trust, felonies under federal or state law). The expedited process allows suspension without full disciplinary proceedings because the criminal conviction demonstrates conduct warranting immediate action. State bar suspension can also trigger expedited procedures. The conviction provides sufficient basis for suspension without lengthy administrative proceedings.

**64. Correct Answer: B (Tax crime)**

Immediate suspension (without a hearing) applies when a practitioner is found guilty of a tax crime or crime involving dishonesty or breach of trust. The criminal conviction demonstrates conduct incompatible with practice before the IRS, justifying immediate suspension to protect taxpayers and tax administration. The practitioner can contest the suspension, but it takes effect immediately upon conviction. This differs from regular disciplinary proceedings which require hearings before sanctions are imposed.

**65. Correct Answer: D (Other sanctions)**

Monetary penalties for Circular 230 violations can be imposed in addition to other sanctions including censure, suspension, or disbarment. Penalties are \$1,000 per violation for practitioners and up to \$50,000 for firms. The monetary penalty is supplemental—it doesn't replace other disciplinary sanctions but can be added to them. This allows comprehensive sanctions addressing both punishment (monetary penalty) and practice restrictions (censure, suspension, disbarment) for serious violations.

**66. Correct Answer: C (Not mandatory)**

Best practices under Circular 230 Section 10.33 are aspirational guidelines, not mandatory enforceable standards. They recommend practices for establishing facts, communicating with clients, and providing quality service. Following best practices is encouraged but violations don't result in discipline. Best practices provide a framework for professional service quality and help practitioners avoid issues.

**67. Correct Answer: B (Correctness of representations)**

Practitioners must exercise due diligence in preparing returns and documents, determining the correctness of oral or written representations to the Department of Treasury and IRS, and determining the correctness of representations to clients regarding tax matters. This standard requires reasonable inquiry and verification but not auditing or guaranteeing accuracy. Practitioners must use reasonable care and competence.

**68. Correct Answer: D (Competent)**

Practitioners relying on advice of another professional must use reasonable care in selecting the advisor and can rely on the advice if the advisor is competent and the reliance is reasonable. The

advisor doesn't need to be an attorney or any specific credential—the focus is on competence in the specific matter. However, practitioners cannot blindly rely on advice without reasonable evaluation.

**69. Correct Answer: B (IRS or Treasury)**

Under Circular 230 Section 10.51, practitioners cannot willfully, recklessly, or through gross incompetence give false or misleading information to the IRS or Treasury Department. This prohibition protects the integrity of tax administration by requiring truthful, accurate communications with the IRS. While practitioners should also be honest with clients and courts, this specific Circular 230 provision addresses communications with the IRS and Treasury. Violations can result in censure, suspension, disbarment, or monetary penalties.

**70. Correct Answer: A (Disclosed)**

Tax return positions must be disclosed (using Form 8275 or 8275-R) if they lack substantial authority but have at least a reasonable basis. Disclosure protects against accuracy-related penalties for positions with reasonable basis but not substantial authority. Positions without even reasonable basis should not be taken. Substantial authority positions don't require disclosure to avoid penalties.

**71. Correct Answer: B (3 years)**

Tax return preparers must retain copies of returns prepared or a list of returns prepared for 3 years from the close of the return period. The retention requirement helps the IRS verify preparer compliance and conduct enforcement. Preparers can retain paper copies, electronic copies, or lists with identifying information. Records must be available for IRS inspection.

**72. Correct Answer: B (\$250)**

Return information disclosure violations under Section 7216 result in penalties of \$250 per disclosure, with a maximum of \$10,000 per calendar year. These civil penalties protect taxpayer privacy by deterring preparers from unauthorized use or disclosure of tax return information. Criminal penalties (up to \$1,000 fine and 1 year imprisonment) can also apply. The per-disclosure penalty accumulates for multiple violations, but the annual cap limits total civil penalties while still creating meaningful deterrence.

**73. Correct Answer: B (PTIN)**

The signing preparer is identified by their Preparer Tax Identification Number (PTIN), which must appear on the return along with their signature. The PTIN is the primary identifier for paid preparers—it's required for anyone who prepares returns for compensation. The preparer's name and address also appear on the return, but the PTIN is the key identifier used by the IRS to track preparers and assess preparer penalties. State license numbers aren't required on federal returns.

**74. Correct Answer: A (Unlimited)**

Preparer penalties apply per return or claim prepared, so total penalties can be unlimited. Each violation creates a separate penalty. For example, a preparer who takes unreasonable positions on 100 returns could face penalties on all 100 returns. The per-return penalty structure (rather than annual caps) creates strong incentives for proper return preparation because systematic violations across many clients create massive penalty exposure. This encourages preparers to ensure all returns meet professional standards.

**75. Correct Answer: D (50% of income)**

The unreasonable position penalty under Section 6694(a) is the greater of \$1,000 or 50% of the income derived by the preparer from preparing the return. This penalty applies when positions lack substantial authority and aren't adequately disclosed, or lack reasonable basis even with disclosure. The percentage-based penalty ensures the penalty is proportional to the compensation received.

**76. Correct Answer: B (75% of income)**

The willful or reckless conduct penalty under Section 6694(b) is the greater of \$5,000 or 75% of the income derived from preparing the return. This higher penalty (compared to 50% for unreasonable positions) reflects greater culpability for willful attempts to understate tax or reckless or intentional disregard of rules. The penalty applies instead of, not in addition to, the unreasonable position penalty.

**77. Correct Answer: A (\$50)**

Failure to furnish the preparer's identifying number (PTIN) on returns results in a penalty of \$50 per failure, up to a maximum of \$27,000 per calendar year (amounts adjusted for inflation). Every return prepared for compensation must include the preparer's PTIN. The penalty encourages compliance with the identification requirement, helping the IRS track preparer compliance.

**78. Correct Answer: C (\$50 per return)**

Failure to sign a return as preparer results in a penalty of \$50 per return, up to \$27,000 per year. The signing preparer (the person with primary responsibility for overall accuracy) must manually or electronically sign the return. The signature requirement creates accountability and helps the IRS identify preparers. Repeated failures create significant cumulative penalties.

**79. Correct Answer: D (\$10,000)**

Aiding and abetting understatement of tax liability results in a penalty of \$1,000 for individual returns or \$10,000 for corporate returns, per taxpayer per document. This penalty applies to non-preparers who assist in understating tax liabilities, such as promoters, advisors, or others who knowingly participate in tax evasion. The higher penalty for corporate returns reflects the larger tax amounts typically involved.

**80. Correct Answer: B (\$10,000 per year)**

The penalty for unauthorized disclosure or use of tax return information by preparers is \$250 per disclosure or use, up to a maximum of \$10,000 per calendar year. The annual cap limits total exposure while the per-violation penalty creates deterrence. Criminal penalties (up to \$1,000 fine and 1 year imprisonment) can also apply. These penalties protect taxpayer privacy.

**81. Correct Answer: A (HOH)**

Preparer due diligence requirements under Section 6695(g) apply to returns claiming the Earned Income Tax Credit (EITC), Child Tax Credit (CTC), Additional Child Tax Credit (ACTC), American Opportunity Tax Credit (AOTC), and Head of Household (HOH) filing status. These credits and filing status are subject to significant improper claims, so preparers must exercise heightened diligence. Form 8867 must be completed.

**82. Correct Answer: C (\$590)**

The due diligence penalty is \$590 per failure (per credit or HOH filing status) for 2024, adjusted annually for inflation. If a return claims multiple credits subject to due diligence (EITC, CTC, and AOTC), the penalty is \$590 for each credit, potentially totaling \$1,770 for one return. The significant per-failure penalty encourages careful compliance with due diligence requirements.

**83. Correct Answer: C (Should have known)**

The knowledge standard for due diligence is that the preparer knew or reasonably should have known that information was incorrect or incomplete. This objective standard holds preparers responsible for information they should know based on reasonable inquiry. Preparers cannot turn a blind eye to obvious errors or inconsistencies. Due diligence requires asking appropriate questions and documenting inquiries.

**84. Correct Answer: B (3 years)**

Form 8867, Paid Preparer's Due Diligence Checklist, must be completed for each return claiming covered credits (EITC, CTC, ACTC, AOTC) or HOH filing status, and retained for 3 years from the later of the return due date or filing date. The form documents the preparer's due diligence inquiries and determinations. Failure to complete, submit with returns internally, or retain Form 8867 results in penalties.

**85. Correct Answer: C (Documents)**

Preparers must make reasonable inquiries when information appears incorrect, inconsistent, or incomplete, based on information from the client, documents, or other sources. Preparers cannot ignore implications of information provided or red flags in documents or third-party information. The duty extends to all information sources, not just client representations. Reasonable inquiry is required when any information raises questions.

**86. Correct Answer: D (Questionable)**

Record of questions asked and client answers must be documented when information appears questionable, incorrect, or incomplete. This documentation demonstrates due diligence was performed and protects preparers from penalties. The records should show what questions were asked, what answers were received, and how the preparer verified or reconciled questionable information. Contemporary documentation is most persuasive.

**87. Correct Answer: B (Knowledge-based authentication)**

Electronic signatures on returns require specific IRS procedures and the practitioner must verify the identity of the signer using knowledge-based authentication or other approved methods. Knowledge-based authentication uses questions based on the taxpayer's financial history or public records to verify identity. Proper authentication prevents unauthorized electronic signatures and identity theft.

**88. Correct Answer: B (Signature authorization)**

Electronic Return Originators (EROs) are responsible for receiving taxpayer information, reviewing returns with taxpayers, and obtaining signature authorization on Form 8879 (or other approved forms). The ERO ensures the taxpayer understands and approves the return before transmitting it electronically. EROs must maintain taxpayer authentication and signature authorization records to demonstrate proper authorization.

**89. Correct Answer: C (Other information)**

The self-select PIN method allows taxpayers to electronically sign returns using either their prior year AGI or prior year PIN, combined with date of birth or other personal information. The IRS uses these data points to authenticate the taxpayer's identity. The self-select PIN provides a convenient alternative to signed paper declarations while maintaining security through multi-factor authentication.

**90. Correct Answer: C (Form 2848)**

A practitioner PIN that allows a representative to sign a tax return electronically requires authorization through Form 2848, Power of Attorney and Declaration of Representative, with specific language granting authority to sign the return. The Form 2848 must explicitly state the representative is authorized to sign the return on the taxpayer's behalf. Simply having representation authority isn't sufficient—the power of attorney must specifically grant signature authority. The practitioner uses the PIN in conjunction with this authorization to electronically sign returns for clients.

**91. Correct Answer: C (11 returns)**

The electronic filing mandate requires tax return preparers who reasonably expect to file more than 10 returns during the calendar year (11 or more returns) to file electronically. The threshold applies to individual, corporate, partnership, and other returns combined. Preparers filing 10 or fewer

returns are exempt from mandatory e-file. This encourages electronic filing while exempting very small volume preparers.

**92. Correct Answer: A (8948)**

Form 8948, Preparer Explanation for Not Filing Electronically, is used to request a hardship waiver from the electronic filing requirement. Tax preparers who reasonably expect to file 11 or more individual income tax returns must file electronically unless they receive a waiver. Form 8948 explains the reason for the hardship (such as systems failure, natural disaster, or other legitimate reasons preventing electronic filing). The waiver must be requested for each return filed on paper when the preparer is subject to the e-file requirement.

**93. Correct Answer: B (Compensation)**

A paid preparer is anyone who prepares all or substantially all of a return or claim for refund for compensation. The amount of compensation doesn't matter—even nominal payment creates preparer status. Preparing returns for free for friends or family doesn't create preparer status for penalty purposes (though PTINs may still be required if preparing for others as a business).

**94. Correct Answer: D (Signing preparer)**

The person who employs one or more preparers and has final responsibility and authority for the tax return is the signing preparer. The signing preparer has primary responsibility for the overall substantive accuracy of the return. There can be only one signing preparer per return, even when multiple people work on it. The signing preparer signs the return (manually or electronically) and their PTIN appears in the paid preparer section. They're subject to preparer penalties for the entire return.

**95. Correct Answer: C (20%)**

A nonsigning preparer is subject to penalties when they prepare a "substantial portion" of a return, defined as a schedule or entry that affects tax liability (or refund or credit) of at least the lesser of \$10,000 or 20% of the gross income (or gross proceeds or total tax) shown on the return. For most individual returns, the test is \$10,000 or 20% of gross income. For corporations and other business returns, the threshold is \$400,000 or 20%. The substantial portion test determines when assistants who prepare parts of returns become subject to preparer penalties.

**96. Correct Answer: C (Tax amounts)**

Substantial portion determination for nonsigning preparers considers the length and complexity of the schedule or portion, and the tax amounts (or refund amounts, loss amounts, credit amounts) involved. All factors are evaluated together. A mechanically complex schedule may be substantial even if tax amounts are small. Conversely, schedules with large tax impact may be substantial even if mechanically simple.

**97. Correct Answer: B (Credits or deductions)**

Schedules attached to returns can create substantial portions if they affect significant credits, deductions, income items, or other material tax positions. Examples include Schedule C (self-employment income), Schedule E (rental income), or schedules for complex transactions. The determination focuses on materiality and complexity. Minor or ministerial schedules are unlikely to constitute substantial portions.

**98. Correct Answer: D (Preparation)**

Tax return preparer does not include persons providing only mechanical assistance such as typing, reproduction, or other assistance where the assistant doesn't exercise judgment or provide tax advice. If the person provides computation, advisory services, or prepares portions involving judgment about tax positions, they may be preparers. The key distinction is whether tax expertise or judgment is involved.

**99. Correct Answer: A (2013)**

The Registered Tax Return Preparer (RTRP) program, which would have required testing and continuing education for all paid preparers, was discontinued in 2013 after federal courts ruled the IRS lacked authority to regulate preparers beyond those specifically authorized by Congress. The program began in 2011 but was invalidated by the courts. Preparers who completed RTRP requirements retain that education but the credential has no legal significance.

**100. Correct Answer: C (1040 issues)**

The Annual Filing Season Program (AFSP) requires participants to complete 18 hours of continuing education annually (6 hours federal tax law updates, 2 hours ethics, 10 hours other federal tax topics) AND pass a comprehension test covering Form 1040 individual income tax return issues. The test is administered by IRS-approved continuing education providers and assesses understanding of individual taxation topics relevant to Form 1040 preparation. Passing the test demonstrates competency in preparing individual income tax returns. AFSP participants receive a Record of Completion and limited practice rights allowing them to represent taxpayers before revenue agents and customer service representatives on returns they prepared and signed, similar to unenrolled preparers.

