# PRACTICE EXAM 17: ENROLLED AGENT SEE PART 1 — INDIVIDUALS SIMULATION (100 QUESTIONS)

*This practice exam contains 100 multiple-choice questions covering all six content domains of the IRS Special Enrollment Examination (SEE) Part 1: Individuals, weighted to mirror the official exam's domain proportions. Select the single best answer for each question. An Answer Key and full explanations follow the questions. Time allotted for the actual SEE Part 1 exam is 3.5 hours; use this same time limit for a realistic simulation.*

**1.** A preparer's client provides a Form 1099-NEC reporting nonemployee compensation from a company the client states was actually a genuine hobby activity, not a business. What is the preparer's generally recommended first step regarding this specific characterization question?

A. Generally gather facts about the activity's regularity, profit motive, and manner of operation to determine whether it actually constitutes a trade or business rather than simply accepting either label
B. Generally accept the client's own characterization automatically without asking any further question, since only the client can ever know the activity's own true nature
C. Generally report the income as wages on Form 1040 regardless of the Form 1099-NEC, since nonemployee compensation is never treated any differently from ordinary wages
D. Generally refuse to prepare the return until the payer issues a corrected form, even though the underlying factual characterization question remains entirely unresolved either way

**2.** A preparer's client asks whether the preparer generally must independently verify a client's claimed home office square footage before using the simplified home office deduction method. What is the general recommended practice regarding this specific figure?

A. Generally must personally visit the client's home and physically measure the office space before ever preparing any return claiming this specific deduction
B. Generally may never rely on any client-provided figure at all, requiring a certified third-party appraisal before claiming any home office deduction whatsoever
C. Generally has no obligation at all to ask any follow-up question, and should accept any figure the client provides without any further consideration

D. Generally should ask reasonable follow-up questions and rely on the client's own representation unless the figure appears implausible given the home's overall known size

**3.** A preparer's client asks about the general purpose of Circular 230's competence standard as applied to a preparer taking on a new, unfamiliar area of tax law. What does this specific standard generally require?

A. Generally requires the preparer to hold a specific advanced credential beyond the Enrolled Agent designation before ever accepting any new or unfamiliar type of engagement
B. Generally requires the preparer to possess the necessary knowledge, skill, and preparation to competently handle the matter, or to associate with someone who does before proceeding
C. Generally requires the preparer to decline every engagement involving any topic not covered in the preparer's own original continuing education coursework, with no exception
D. Generally imposes no requirement at all, since Circular 230 generally addresses only advertising and fee arrangements rather than any competence-related standard

**4.** A preparer's client asks whether the preparer generally must inform the client about penalties that could apply if the client fails to timely file an extension request when the client cannot complete the return by the original due date. What is the general answer to this specific question?

A. Generally no; a preparer generally has no obligation at all to discuss any penalty consequence, since penalty avoidance is generally considered solely the client's own responsibility
B. Generally yes, but only if the client actually owes additional tax, with no similar advisory obligation applying to a client expecting a refund for the year
C. Generally yes; a preparer generally should advise the client of applicable late-filing and late-payment penalty exposure so the client can make an informed decision about requesting an extension
D. Generally no; discussing penalty consequences is generally considered a form of unauthorized legal advice, regardless of the preparer's own specific professional credential

**5.** A preparer's client asks about the general difference between the IRS Collection Statute Expiration Date and the assessment statute of limitations. What is the general distinction between these two specific limitation periods?

A. The assessment statute generally limits how long the IRS has to assess additional tax after a return is filed, while the collection statute generally limits how long the IRS has to collect an assessed liability
B. The assessment statute and the collection statute are generally functionally identical periods in every respect, with no meaningful distinction between the two specific limitation periods
C. The collection statute generally limits how long the IRS has to assess additional tax, while the assessment statute generally limits how long the IRS has to collect that tax
D. The assessment statute generally applies only to a business return, while the collection statute generally applies only to an individual taxpayer's own personal return

**6.** A preparer's client asks whether a preparer generally must obtain the client's affirmative consent before using the client's tax return information for the preparer's own internal statistical analysis, even without disclosing that information to any outside party. What is the general answer to this specific question?

A. Generally no; a preparer generally may use tax return information for any internal purpose at all without ever obtaining the client's own consent, provided no outside disclosure occurs
B. Generally yes; using tax return information for a purpose other than preparing the return generally requires the client's consent, even for an internal use that involves no outside disclosure
C. Generally yes, but only if the internal analysis actually generates revenue for the preparer, with no similar consent requirement applying to a non-revenue-generating internal use
D. Generally no; consent requirements generally apply only to an actual disclosure to a third party, with any purely internal use being entirely exempt under all circumstances

**7.** A preparer's client asks about the general purpose of an IRS Notice of Deficiency, commonly called a 90-day letter. What is the general purpose this specific notice generally serves for a taxpayer?

A. Generally serves exclusively as a final bill demanding immediate payment, with no further opportunity at all for the taxpayer to dispute the underlying proposed adjustment
B. Generally serves no actual practical purpose at all for a taxpayer, existing only as an optional informational notice with no genuine legal significance or deadline
C. Generally serves exclusively to notify the taxpayer of a completed criminal referral, rather than of any proposed civil tax adjustment or examination result
D. Generally notifies the taxpayer of a proposed tax adjustment and generally provides the taxpayer 90 days to petition the United States Tax Court before the IRS actually assesses the additional tax

**8.** A preparer's client asks whether the preparer generally may rely on a client's own oral statement regarding the cost basis of a security sold during the year, absent any brokerage statement or other documentation. What is the general recommended approach regarding this specific situation?

A. Generally must refuse to report any sale at all until the client actually produces a formal brokerage statement, regardless of how reasonable the client's own oral statement might be

B. Generally may report the sale using a cost basis of zero automatically, regardless of whether the client's own oral statement regarding actual cost basis seems reasonable or credible

C. Generally should ask the client to attempt to locate supporting documentation, and if none is available, generally may rely on a reasonable, credible client statement while noting the limitation

D. Generally may never rely on any oral client statement under any circumstance, even where the client's own account is entirely reasonable, consistent, and internally credible

**9.** A preparer's client asks about the general purpose of an IRS Centralized Authorization File number, commonly called a CAF number, assigned to a preparer. What is the general purpose this specific number generally serves?

A. Generally serves exclusively as the preparer's own personal taxpayer identification number, replacing the preparer's Social Security number entirely for all federal filing purposes

B. Generally serves no actual practical purpose at all, existing only as an optional cosmetic identifier with no genuine effect on a preparer's representation capability

C. Generally serves exclusively as a payment processing number the IRS uses to pay a preparer's own refund, rather than serving any authorization-related purpose

D. Generally identifies a preparer's power of attorney and tax information authorization records within the IRS system, streamlining future representation and information requests for that specific preparer

**10.** A preparer's client asks whether the preparer generally must retain electronic records with the same rigor as paper records when both formats document the same underlying supporting information. What is the general answer to this specific question?

A. Generally no; electronic records generally carry no retention obligation at all, since only an original paper record generally satisfies any applicable recordkeeping requirement

B. Generally yes; electronic records generally must be maintained with reasonable safeguards and generally must remain reasonably accessible and legible, similar to the standard generally applied to paper records

C. Generally yes, but only if the client actually requests electronic retention specifically, with paper retention otherwise being the exclusively required default format in every case

D. Generally no; retention obligations generally apply only to a business client, with an individual client's own records generally being entirely exempt from any retention standard

**11.** A preparer's client asks whether the preparer generally has an obligation to advise a client about the availability of injured spouse relief when the client's refund on a jointly filed return was entirely applied to the other spouse's separate past-due debt. What is the general answer to this specific question?

A. Generally yes; a preparer generally should advise the client about injured spouse relief, since it may generally allow the client to recover the client's own separate share of the joint refund

B. Generally no; a preparer generally has no obligation at all to mention this specific relief, since the IRS is generally required to notify the client independently instead

C. Generally yes, but only if the underlying debt actually belongs to a federal agency, with no similar advisory obligation applying to a debt owed to a state agency

D. Generally no; discussing injured spouse relief is generally considered a form of unauthorized legal advice, regardless of the preparer's own specific professional credential

**12.** A preparer's client asks about the general effect of a preparer's own PTIN, Preparer Tax Identification Number, expiring due to a missed renewal. What is the general effect of an expired PTIN on the preparer's ability to prepare returns for compensation?

A. Generally, an expired PTIN generally has no effect at all on a preparer's ability to prepare returns for compensation, since PTIN renewal is generally considered purely optional

B. Generally, an expired PTIN generally converts the preparer's own status automatically to an unenrolled preparer, though the preparer generally may continue preparing returns without any further restriction

C. Generally, a preparer with an expired PTIN generally may not lawfully prepare a federal tax return for compensation until the PTIN is actually renewed through the applicable IRS process

D. Generally, an expired PTIN generally results in automatic permanent disbarment from ever preparing any federal tax return again, regardless of whether the preparer later attempts renewal

**13.** A preparer's client asks whether the preparer generally must disclose to the client the specific fee the preparer charges before actually beginning work on the client's return. What is the general recommended best practice regarding this specific fee disclosure?

A. Generally, a preparer generally has no obligation at all to disclose any fee information before, during, or after completing the client's return under any circumstance
B. Generally, best practice recommends disclosing the fee structure or a reasonable estimate to the client before beginning work, supporting transparency and helping to avoid a later billing dispute
C. Generally, fee disclosure is generally required only after the return is actually completed and filed, rather than at any point before work on the return actually begins
D. Generally, fee disclosure obligations generally apply only to a CPA firm, with an Enrolled Agent generally being entirely exempt from any fee transparency best practice

**14.** A preparer's client asks about the general purpose of Form 8867, the Paid Preparer's Due Diligence Checklist, when the client claims the Earned Income Tax Credit. What is the general purpose this specific form generally serves?

A. Generally serves exclusively as an optional worksheet with no actual filing or retention requirement at all, existing only for the preparer's own personal internal reference
B. Generally serves exclusively as the form the client, rather than the preparer, must complete and sign before the preparer may ever claim any refundable credit
C. Generally serves no purpose at all specific to a refundable credit, applying instead only to a client claiming an itemized deduction rather than any tax credit
D. Generally documents the preparer's own due diligence in determining the client's eligibility for certain refundable credits, and generally must be completed and retained by the preparer

**15.** A preparer's client asks whether the preparer generally must advise the client separately about state income tax filing obligations when the preparer's engagement letter covers only the preparation of the client's federal return. What is the general recommended practice regarding this specific scope limitation?

A. Generally recommends clearly stating the engagement's scope in writing, and if state filing is excluded, advising the client that a separate state filing obligation may still exist

B. Generally recommends never mentioning state tax obligations at all, since a preparer engaged only for a federal return generally has no reason to reference any other filing obligation

C. Generally recommends automatically preparing the client's state return regardless of the engagement's stated scope, since federal and state returns are generally never treated separately

D. Generally recommends refusing to prepare the federal return at all unless the client separately and simultaneously engages the preparer to prepare every applicable state return too

**16.** A preparer's client asks about the general effect of the IRS's Annual Filing Season Program on an unenrolled preparer's limited representation rights before the IRS. What is the general benefit this specific voluntary program generally provides?

A. Generally grants a participating unenrolled preparer the exact same full, unlimited representation rights before the IRS that an Enrolled Agent generally already possesses

B. Generally provides no meaningful benefit at all to a participating unenrolled preparer, since representation rights generally remain identical regardless of program participation

C. Generally allows a participating unenrolled preparer limited representation rights before the IRS regarding a return the preparer actually prepared and signed, unlike a non-participating unenrolled preparer

D. Generally applies only to a preparer who already holds an Enrolled Agent credential, rather than applying specifically to an otherwise unenrolled, non-credentialed preparer

**17.** A taxpayer's total income includes tips received directly from customers during the year, reported by the taxpayer to the employer as required. How is this specific tip income generally treated for federal income tax purposes?

A. Generally entirely tax-exempt, since tip income received directly from a customer is generally treated as a nontaxable gift rather than as any form of taxable compensation

B. Generally taxable only at a specific reduced flat 10% rate reserved specifically for tip income, rather than at the taxpayer's own ordinary wage tax rate

C. Generally fully taxable as ordinary income, subject to income tax and generally subject to Social Security and Medicare tax, in the same general manner as the taxpayer's other regular wages

D. Generally treated as self-employment income exclusively, subjecting the tip income to self-employment tax rather than to the regular payroll tax treatment that generally applies to wages

**18.** A taxpayer's total income includes a distribution received from a qualified annuity purchased with pretax funds, where the entire distribution represents taxable earnings and original pretax contributions. How is this specific annuity distribution generally treated for federal income tax purposes?

A. Generally entirely tax-exempt, since an annuity distribution is generally treated as a nontaxable return of the taxpayer's own original invested principal regardless of funding source
B. Generally taxable only at the specific reduced flat 10% rate reserved specifically for a qualified annuity distribution under current federal tax law, rather than at ordinary rates
C. Generally treated as self-employment income, subjecting the annuity distribution to self-employment tax in addition to any regular income tax that might otherwise apply
D. Generally fully taxable as ordinary income in the year actually received, since the annuity was purchased entirely with pretax funds and no portion represents the taxpayer's own after-tax basis

**19.** A taxpayer's total income includes a payment received from a former employer as back pay awarded through a wrongful termination lawsuit settlement, specifically compensating the taxpayer for lost wages the taxpayer would have earned had the termination not occurred. How is this specific back pay award generally treated?

A. Generally entirely tax-exempt, since a back pay award arising from a wrongful termination lawsuit is generally treated identically to a settlement for personal physical injury
B. Generally fully taxable as ordinary wage income, since the award generally stands in the place of wages the taxpayer would otherwise have earned had the wrongful termination not actually occurred
C. Generally taxable only as to 50% of the award amount, with the remaining 50% generally treated as an entirely tax-exempt return of the taxpayer's own prior investment
D. Generally treated as a nontaxable gift from the former employer, rather than as any form of currently taxable compensation for the taxpayer's own lost wages

**20.** A taxpayer's total income includes a distribution received from a traditional IRA taken due to the taxpayer becoming a first-time homebuyer, used toward the purchase of a qualifying principal residence. How is this specific first-time homebuyer distribution generally treated regarding the 10% early distribution penalty?

A. Generally excepted from the 10% early distribution penalty, up to an applicable lifetime dollar limit, though the distribution itself remains includible in the taxpayer's ordinary taxable income

B. Generally entirely tax-exempt and entirely excepted from the 10% penalty, since a first-time homebuyer distribution is generally excluded from taxable income altogether under current law

C. Generally still subject to the full 10% early distribution penalty in every case, since the specific first-time homebuyer exception generally applies only to a Roth IRA, not a traditional IRA

D. Generally excepted from ordinary income tax entirely, but the 10% early distribution penalty generally still fully applies regardless of the taxpayer's own first-time homebuyer status

**21.** A taxpayer's total income includes a payment received from a state as an income tax refund for a prior year in which the taxpayer claimed the standard deduction rather than itemizing. How is this specific state income tax refund generally treated under the tax benefit rule?

A. Generally fully taxable as ordinary income, exactly the same treatment that generally applies to a state tax refund received by a taxpayer who actually itemized deductions in the prior year

B. Generally taxable only at the specific reduced flat 10% rate reserved specifically for a state tax refund under current federal tax law, rather than being entirely excluded

C. Generally treated as self-employment income, subjecting the state tax refund to self-employment tax in addition to any regular income tax that might otherwise apply

D. Generally not taxable income, since a state tax refund generally is not taxable when the taxpayer claimed the standard deduction in the prior year and thus received no federal tax benefit from the deduction

**22.** A taxpayer's total income includes a payment received from an employer as reimbursement for the cost of employer-required safety equipment the taxpayer purchased and substantiated under an accountable plan arrangement. How is this specific reimbursement generally treated?

A. Generally fully taxable as ordinary wage income, exactly the same treatment that generally applies to an unsubstantiated reimbursement made outside a genuine accountable plan arrangement

B. Generally not includible in the employee's taxable wages, since a properly substantiated reimbursement under a genuine accountable plan is generally excluded from taxable compensation

C. Generally taxable only at the specific reduced flat 10% rate reserved specifically for a safety equipment reimbursement under current federal tax law, rather than being entirely excluded

D. Generally treated as self-employment income to the employee, subjecting the reimbursement to self-employment tax rather than to the regular payroll withholding that generally applies to wages

**23.** A taxpayer's total income includes a payment received as a prize for winning a local raffle conducted by a nonprofit organization, paid in cash rather than in the form of merchandise. How is this specific raffle prize generally treated for federal income tax purposes?

A. Generally fully taxable as other income in the year actually received, regardless of the specific nonprofit status of the organization that actually conducted the raffle
B. Generally entirely tax-exempt, since a prize won through a raffle conducted by a nonprofit organization is generally treated as a nontaxable charitable benefit to the winner
C. Generally taxable only at the specific reduced flat 10% rate reserved specifically for a raffle prize under current federal tax law, rather than at ordinary income tax rates
D. Generally treated as self-employment income, subjecting the raffle prize to self-employment tax in addition to any regular income tax that might otherwise apply to the winner

**24.** A taxpayer's total income includes a payment received from a former employer as a payment made under a nonqualified stock option that the taxpayer exercised during the year, recognizing ordinary income equal to the option's bargain element at exercise. How is this specific bargain element generally treated?

A. Generally entirely tax-exempt at exercise, with taxation instead deferred entirely until the taxpayer actually sells the underlying stock at some later date
B. Generally taxable only at the specific reduced flat 10% rate reserved specifically for a nonqualified stock option exercise under current federal tax law, rather than at ordinary rates
C. Generally fully taxable as ordinary income at exercise, equal to the excess of the stock's fair market value over the exercise price the taxpayer actually paid
D. Generally treated as long-term capital gain at exercise, exactly the same treatment that generally applies to the eventual sale of the underlying stock itself

**25.** A taxpayer's total income includes a distribution received from a Coverdell Education Savings Account used for a nonqualifying expense, unrelated to any qualifying education cost. How is the earnings portion of this specific nonqualified Coverdell distribution generally treated?

A. Generally entirely tax-exempt, exactly the same treatment that generally applies to a properly qualified Coverdell distribution used for a genuine qualifying education expense

B. Generally taxable only at the specific reduced flat 10% rate reserved specifically for a nonqualified Coverdell distribution, rather than at the taxpayer's own ordinary income tax rate

C. Generally treated as a nontaxable return of the taxpayer's own original contribution, rather than as any form of currently taxable earnings on that contributed amount

D. Generally taxable as ordinary income and generally subject to an additional 10% penalty tax, since the distribution does not meet the requirements to be treated as a qualified education distribution

**26.** A taxpayer's total income includes a payment received from a state as a property tax rebate specifically tied to the taxpayer's own principal residence, available broadly to qualifying homeowners regardless of income level. How is this specific property tax rebate generally treated for federal income tax purposes?

A. Generally not taxable income if the taxpayer did not previously deduct the underlying property tax as an itemized deduction, or was not itemizing in the year the tax was actually paid

B. Generally fully taxable as ordinary income in every case, exactly the same treatment that generally applies regardless of whether the taxpayer actually itemized deductions in the prior year

C. Generally taxable only at the specific reduced flat 10% rate reserved specifically for a property tax rebate under current federal tax law, rather than being potentially excluded

D. Generally treated as self-employment income, subjecting the property tax rebate to self-employment tax in addition to any regular income tax that might otherwise apply

**27.** A taxpayer's total income includes a payment received from an employer as an award for the taxpayer's twenty-five years of continuous service, given in the form of tangible personal property rather than cash, within the applicable dollar limits for a qualified plan award. How is this specific length-of-service award generally treated?

A. Generally fully taxable as ordinary wage income in every case, exactly the same treatment that generally applies to a cash bonus paid for the taxpayer's own general performance

B. Generally excludable from the employee's taxable wages up to the applicable dollar limit, provided the award is tangible personal property given under a qualified, nondiscriminatory length-of-service award plan

C. Generally taxable only at the specific reduced flat 10% rate reserved specifically for a length-of-service award under current federal tax law, rather than being potentially excludable

D. Generally treated as self-employment income, subjecting the length-of-service award to self-employment tax in addition to any regular income tax that might otherwise apply

**28.** A taxpayer's total income includes a payment received from a former employer as a payment for accrued but unused sick leave, paid out in a lump sum upon the taxpayer's retirement. How is this specific accrued sick leave payout generally treated?

A. Generally entirely tax-exempt, since a lump-sum accrued sick leave payout is generally treated as a nontaxable return of the employee's own previously earned time off
B. Generally taxable only at a specific reduced flat 10% rate reserved specifically for an accrued sick leave payout, rather than at the taxpayer's own ordinary wage rate
C. Generally fully taxable as ordinary wage income, subject to regular income tax withholding and employment tax, in the same general manner as the taxpayer's other regular wages
D. Generally treated as self-employment income, subjecting the accrued sick leave payout to self-employment tax rather than to the regular payroll withholding that generally applies to wages

**29.** A taxpayer's total income includes a distribution received from a traditional IRA taken due to the birth of the taxpayer's child during the year, within the applicable dollar limit for this specific qualified birth distribution. How is this specific distribution generally treated regarding the 10% early distribution penalty?

A. Generally excepted from the 10% early distribution penalty under the specific qualified birth or adoption distribution exception, though the distribution itself remains includible in ordinary taxable income
B. Generally entirely tax-exempt and entirely excepted from the 10% penalty, since a qualified birth distribution is generally excluded from taxable income altogether under current law
C. Generally still subject to the full 10% early distribution penalty in every case, since the specific qualified birth exception generally applies only to a 401(k) plan, not an IRA
D. Generally excepted from ordinary income tax entirely, but the 10% early distribution penalty generally still fully applies regardless of the birth of the taxpayer's own child

**30.** A taxpayer's total income includes a distribution received from a traditional IRA taken while the taxpayer is unemployed, used specifically to pay for health insurance premiums during the period of unemployment, meeting the applicable specific statutory requirements for this exception. How is this specific distribution generally treated regarding the 10% early distribution penalty?

A. Generally entirely tax-exempt and entirely excepted from the 10% penalty, since a distribution used for health insurance premiums during unemployment is generally excluded from taxable income altogether

B. Generally still subject to the full 10% early distribution penalty in every case, since the specific unemployment health insurance exception generally applies only to a 401(k) plan, not an IRA

C. Generally excepted from the 10% early distribution penalty under the specific unemployed health insurance premium exception, though the distribution itself remains includible in ordinary taxable income

D. Generally excepted from ordinary income tax entirely, but the 10% early distribution penalty generally still fully applies regardless of the taxpayer's own unemployment status

**31.** A taxpayer's total income includes a payment received from an employer as a de minimis fringe benefit, specifically an occasional small-value item such as a holiday turkey or a modest gift card, provided infrequently and of minimal value. How is this specific de minimis fringe benefit generally treated?

A. Generally fully taxable as ordinary wage income in every case, exactly the same treatment that generally applies to a substantial cash bonus paid for the taxpayer's own general performance

B. Generally taxable only at the specific reduced flat 10% rate reserved specifically for a de minimis fringe benefit under current federal tax law, rather than being potentially excludable

C. Generally treated as self-employment income, subjecting the de minimis fringe benefit to self-employment tax in addition to any regular income tax that might otherwise apply

D. Generally excludable from the employee's taxable wages, since a genuine de minimis fringe benefit of minimal value, provided infrequently, is generally not includible in taxable compensation

**32.** A taxpayer's total income includes a distribution from a health savings account used to pay Medicare premiums after the taxpayer reaches age 65 and enrolls in Medicare. How is this specific HSA distribution generally treated?

A. Generally fully taxable as ordinary income to the extent the distribution actually exceeds the original amount the taxpayer contributed to the health savings account over its lifetime

B. Generally entirely tax-exempt, since Medicare premiums generally qualify as a qualifying medical expense for HSA distribution purposes once the taxpayer has actually enrolled in Medicare

C. Generally subject to the 20% additional tax penalty automatically, regardless of the taxpayer's own age or Medicare enrollment status at the specific time of the distribution

D. Generally treated as self-employment income, subjecting the distribution to self-employment tax in addition to any regular income tax that might otherwise apply to the taxpayer

**33.** A taxpayer's total income includes a payment received as a whistleblower award from the IRS for information leading to the successful collection of unpaid tax from another taxpayer. How is this specific whistleblower award generally treated for the recipient?

A. Generally entirely tax-exempt, since a whistleblower award paid by the IRS is generally treated as a nontaxable government benefit rather than as any form of taxable compensation
B. Generally taxable only at the specific reduced flat 10% rate reserved specifically for a whistleblower award under current federal tax law, rather than at ordinary income tax rates
C. Generally treated as a nontaxable gift from the IRS, rather than as any form of currently taxable compensation for the information the recipient actually provided
D. Generally fully taxable as ordinary income in the year actually received, reported to the recipient on Form 1099-MISC, since the award generally compensates for services provided to the government

**34.** A taxpayer's total income includes a distribution received from a traditional IRA the taxpayer took under a series of substantially equal periodic payments meeting the requirements of the applicable specific early distribution exception. How is this specific series of payments generally treated regarding the 10% early distribution penalty?

A. Generally entirely tax-exempt and entirely excepted from the 10% penalty, since a series of substantially equal periodic payments is generally excluded from taxable income altogether
B. Generally still subject to the full 10% early distribution penalty in every case, since this specific exception generally applies only to a 401(k) plan, rather than to an IRA
C. Generally excepted from the 10% early distribution penalty, provided the payments continue for the required minimum period without modification, though the distributions themselves remain includible in ordinary taxable income
D. Generally excepted from ordinary income tax entirely, but the 10% early distribution penalty generally still fully applies regardless of whether the payments actually continue as required

**35.** A taxpayer's total income includes a payment received from a former landlord as a refund of a security deposit the taxpayer originally paid at the start of a residential lease, returned in full upon the taxpayer's move-out with no deductions taken. How is this specific security deposit refund generally treated?

A. Generally not taxable income, since a full refund of the taxpayer's own original security deposit generally represents a nontaxable return of the taxpayer's own previously paid funds

B. Generally fully taxable as ordinary income to the taxpayer in the year actually received, exactly the same treatment that generally applies to a rental income payment received by a landlord

C. Generally taxable only at the specific reduced flat 10% rate reserved specifically for a security deposit refund under current federal tax law, rather than being entirely excluded

D. Generally treated as self-employment income, subjecting the security deposit refund to self-employment tax in addition to any regular income tax that might otherwise apply

**36.** A taxpayer's total income includes a distribution received from a traditional 401(k) plan the taxpayer took at age 56 after separating from the employer that sponsored the plan, meeting the requirements of the specific applicable age-55 separation exception. How is this specific distribution generally treated regarding the 10% early distribution penalty?

A. Generally entirely tax-exempt and entirely excepted from the 10% penalty, since a distribution taken after separating from service at age 56 is generally excluded from taxable income altogether

B. Generally excepted from the 10% early distribution penalty under the specific age-55 separation from service exception, though the distribution itself remains includible in ordinary taxable income

C. Generally still subject to the full 10% early distribution penalty in every case, since this specific age-55 separation exception generally applies only to an IRA, rather than to a 401(k) plan

D. Generally excepted from ordinary income tax entirely, but the 10% early distribution penalty generally still fully applies regardless of the taxpayer's own age at separation from service

**37.** A taxpayer itemizes deductions and made a contribution of cash directly to a private nonoperating foundation during the year, rather than to a public charity. What is the general adjusted gross income percentage limitation applicable to this specific type of cash contribution?

A. Generally limited to the same higher 60% of adjusted gross income that generally applies to a cash contribution made directly to a qualified public charity

B. Generally subject to no percentage limitation at all, meaning the entire private foundation cash contribution amount is always fully deductible regardless of the taxpayer's own income

C. Generally limited to 30% of the taxpayer's adjusted gross income for the year, a lower percentage limitation than the 60% generally applicable to a cash gift to a public charity

D. Generally limited to a flat dollar cap of $5,000 per year, rather than to any percentage-of-income based limitation on the specific contribution amount

**38.** A taxpayer paid mortgage insurance premiums during the year on a loan used to acquire the taxpayer's own primary residence. What is the general current-law treatment of these specific mortgage insurance premiums for itemized deduction purposes?

A. Generally treated based on the current applicable statutory provision in effect for the specific tax year, since this deduction has historically been subject to periodic expiration and later extension by Congress
B. Generally always fully deductible without any limitation at all, since mortgage insurance premiums have generally never been subject to any expiration or extension issue under current law
C. Generally always entirely nondeductible, since mortgage insurance premiums have generally never qualified as an itemized deduction under any version of the applicable federal tax law
D. Generally deductible only as an above-the-line adjustment to income, rather than as any form of itemized deduction, regardless of the specific applicable tax year involved

**39.** A taxpayer paid for a nursing home stay for a spouse whose primary reason for residency was receiving necessary medical and nursing care, as distinguished from a stay primarily for personal or custodial reasons. How is this specific nursing home cost generally treated for medical expense deduction purposes?

A. Generally only the portion of the cost attributable to medical care itself is includible, with the meals and lodging portion generally always entirely excluded regardless of the primary reason for the stay
B. Generally the entire cost, including meals and lodging, is generally includible as a qualifying medical expense, since the primary reason for the stay was receiving necessary medical care
C. Generally the entire nursing home cost is entirely excluded from the medical expense deduction, since only an amount paid directly to a physician generally qualifies as a medical expense
D. Generally the nursing home cost qualifies only as a dependent care expense for Child and Dependent Care Credit purposes, rather than as any form of itemized medical expense

**40.** A taxpayer claims a home mortgage interest deduction on a loan that is a mix of acquisition debt used to buy the home and a separate refinanced amount that included cash the taxpayer used to pay off unrelated personal credit card debt. How is the interest on this specific mixed-use refinanced loan generally treated?

A. Generally, the entire refinanced loan's interest remains fully deductible as qualified residence interest, regardless of how any portion of the cash-out proceeds was actually used by the taxpayer

B. Generally, the entire refinanced loan's interest becomes entirely nondeductible the moment any portion of the loan is actually used for a purpose other than acquiring the home

C. Generally, the interest allocable to the credit card debt portion becomes deductible as investment interest expense, rather than continuing to be treated as entirely nondeductible personal interest

D. Generally, only the interest allocable to the original acquisition debt portion is generally deductible as qualified residence interest, with interest on the portion used for credit card debt generally being nondeductible

**41.** A taxpayer's dependent child is enrolled in a graduate degree program at an eligible institution, in the student's sixth year of postsecondary education overall. What is the general reason the American Opportunity Tax Credit is generally unavailable for this specific dependent's tuition?

A. Generally, the American Opportunity Tax Credit generally has no limitation at all on the number of years it may be claimed, meaning graduate study generally remains fully eligible in every case

B. Generally, the American Opportunity Tax Credit generally applies exclusively to a graduate-level program, with an undergraduate program generally being entirely ineligible for this specific credit

C. Generally, the American Opportunity Tax Credit is generally limited to a student's first four years of postsecondary education, and generally is unavailable once a student has already claimed it for four prior years

D. Generally, the American Opportunity Tax Credit generally became entirely unavailable for every taxpayer under current law, having been permanently repealed for every tax year going forward

**42.** A taxpayer paid for a capital improvement to a personal residence specifically recommended by a physician to accommodate the taxpayer's own diagnosed medical condition, such as installing a wheelchair ramp. How is the cost of this specific medically necessary capital improvement generally treated?

A. Generally entirely nondeductible, since a capital improvement to a personal residence is generally always treated as a nondeductible personal expense regardless of any underlying medical necessity

B. Generally deductible in full without any limitation at all, regardless of whether the specific improvement actually increases the home's own fair market value in any way

C. Generally deductible only as an above-the-line adjustment to income, rather than as any form of itemized medical expense subject to the 7.5%-of-adjusted-gross-income floor

D. Generally deductible as a qualifying medical expense to the extent the cost exceeds any resulting increase in the home's own fair market value attributable to the specific improvement

**43.** A taxpayer claims a casualty loss deduction for damage to a personal-use vehicle caused by a federally declared disaster, and the taxpayer itemizes deductions for the year. What is the general per-event and per-year limitation applicable to this specific personal casualty loss?

A. Generally, no per-event or per-year reduction at all applies to a personal casualty loss, meaning the entire loss amount is always fully deductible regardless of any underlying limitation

B. Generally, the deductible loss is generally reduced by $100 per casualty event, and the combined total of all such losses for the year is generally further reduced by 10% of adjusted gross income

C. Generally, the deductible loss is generally reduced by a flat $1,000 per casualty event, rather than by the lower $100 per-event reduction that actually generally applies under current law

D. Generally, the 10%-of-adjusted-gross-income reduction generally applies per casualty event, rather than applying once to the combined total of all casualty losses for the entire year

**44.** A taxpayer claims a deduction for unreimbursed business expenses incurred as an Armed Forces reservist traveling more than 100 miles from home to attend reserve duty. How is this specific reservist travel expense generally treated?

A. Generally deductible as an above-the-line adjustment to income, up to the applicable federal per diem rate, available even to a taxpayer who claims the standard deduction

B. Generally deductible only as a miscellaneous itemized deduction subject to the same 2%-of-adjusted-gross-income floor that generally applies to most other unreimbursed employee expenses

C. Generally entirely nondeductible under current law, since an unreimbursed employee business expense is generally never deductible in any form regardless of the underlying circumstances

D. Generally deductible in an unlimited amount with no applicable per diem-based limitation capping the specific amount a qualifying reservist may generally deduct each year

**45.** A taxpayer claims a Retirement Savings Contributions Credit, the Saver's Credit, but the taxpayer's spouse took a distribution from a retirement plan earlier in the same testing period. What is the general effect of this specific spousal distribution on the taxpayer's own credit calculation?

A. Generally, a spousal distribution generally has no effect at all on the taxpayer's own Saver's Credit calculation, since only the taxpayer's own personal distributions are ever considered
B. Generally, a spousal distribution generally disqualifies the couple entirely and permanently from ever claiming the Saver's Credit again in any future tax year
C. Generally, a distribution taken by either spouse during the applicable testing period generally reduces the amount of qualifying contribution eligible for the credit on the joint return
D. Generally, a spousal distribution generally increases the available credit amount, the exact reverse of the actual general effect that a prior distribution has on this specific credit

**46.** A taxpayer claims a deduction for gambling losses on a return where the taxpayer's only gambling activity for the year was placing wagers through a licensed online sports betting platform, with total losses reported exceeding total winnings for the year. What is the general treatment of this specific gambling loss situation?

A. Generally, the gambling losses remain deductible as an itemized deduction only up to the amount of the taxpayer's reported gambling winnings, with the excess loss beyond winnings generally nondeductible
B. Generally, the entire gambling loss is fully deductible in an unlimited amount, even though the losses actually exceed the taxpayer's own total reported winnings for the year
C. Generally, online sports betting losses receive materially different tax treatment than losses from any other form of gambling, and generally are never deductible in any amount
D. Generally, the gambling losses are generally deductible as an above-the-line adjustment to income, rather than as an itemized deduction subject to any specific winnings-based limitation

**47.** A taxpayer donated a vehicle worth more than $500 to a qualified charity that sold the vehicle rather than using it for the charity's own exempt purpose. What is the general limitation on the taxpayer's charitable deduction for this specific donated vehicle?

A. Generally, the taxpayer's deduction remains based entirely on the vehicle's own fair market value at donation, regardless of the specific amount the charity actually received upon selling it
B. Generally limited to the gross proceeds the charity actually received from selling the vehicle, rather than to the vehicle's own fair market value at the time of the donation itself
C. Generally, no charitable deduction at all is available for a donated vehicle the charity subsequently sells, rather than retaining and using for the charity's own exempt purpose

D. Generally, the taxpayer's deduction is generally limited to a flat $500 regardless of either the vehicle's own fair market value or the actual gross proceeds from any sale

**48.** A taxpayer paid for continuing professional education courses required to maintain the taxpayer's own existing professional license as a self-employed consultant. How is this specific continuing education expense generally treated?

A. Generally entirely nondeductible, since any continuing education expense is generally always treated as a nondeductible personal expense regardless of the taxpayer's own existing profession

B. Generally deductible only as a miscellaneous itemized deduction subject to the same 2%-of-adjusted-gross-income floor that historically applied to an employee's own unreimbursed expense

C. Generally deductible only if the education actually qualifies the taxpayer for an entirely new trade or business, rather than simply maintaining the taxpayer's own existing profession

D. Generally deductible as an ordinary and necessary business expense on Schedule C, since the education generally maintains or improves skills required in the taxpayer's own existing trade or business

**49.** A taxpayer claims a Child Tax Credit for a qualifying child who does not have a Social Security number valid for employment, but does have an Individual Taxpayer Identification Number instead. What is the general effect of this specific identification number limitation on the Child Tax Credit claim?

A. Generally, the child's own specific type of identification number generally has no effect at all on Child Tax Credit eligibility, and the full credit generally remains fully available

B. Generally, the child generally does not qualify for the Child Tax Credit itself under current law, though the child may generally still qualify the taxpayer for the smaller Credit for Other Dependents instead

C. Generally, the child generally qualifies for an enhanced, larger Child Tax Credit amount specifically because the child holds an Individual Taxpayer Identification Number rather than a Social Security number

D. Generally, the taxpayer generally becomes entirely ineligible for any dependent-related credit at all once any dependent lacks a Social Security number valid for employment

**50.** A taxpayer claims an itemized deduction for a cash contribution made to a qualified charity through a payroll deduction plan at work, substantiated by a pay stub and a pledge card from the employer rather than by a receipt from the charity itself. What is the general substantiation standard applicable to this specific type of payroll-deducted contribution?

A. Generally, no substantiation at all is generally required for a payroll-deducted charitable contribution, regardless of the specific total amount actually withheld and donated during the year
B. Generally, only a formal written receipt issued directly by the recipient charity itself generally satisfies the applicable substantiation requirement, with no other combination of documents ever sufficing
C. Generally, a payroll-deducted charitable contribution is generally entirely nondeductible under current law, since only a direct cash contribution made outside of payroll deduction ever qualifies
D. Generally, the combination of a pay stub showing the amount withheld and a pledge card from the charity or employer generally satisfies the applicable substantiation requirement for this type of contribution

**51.** A taxpayer claims the Earned Income Tax Credit, and the taxpayer's qualifying child also happens to have investment income during the year exceeding the applicable disqualifying threshold amount that limits eligibility for this credit. What is the general effect of this specific investment income limitation?

A. Generally, a taxpayer whose own investment income exceeds the applicable disqualifying threshold generally becomes ineligible for the Earned Income Tax Credit entirely for that specific tax year
B. Generally, a qualifying child's own investment income generally has no bearing at all on the taxpayer's own Earned Income Tax Credit eligibility, since only the taxpayer's income is ever considered
C. Generally, exceeding this specific investment income threshold generally reduces, but never entirely eliminates, the taxpayer's otherwise available Earned Income Tax Credit for that specific tax year
D. Generally, this specific investment income threshold generally applies only to a taxpayer with no qualifying child at all, rather than applying to a taxpayer who has one or more

**52.** A taxpayer claims a deduction for interest paid on a loan used to purchase a home office addition operated as a qualifying home-based business, where the loan is separately secured by the home itself and used exclusively for the business addition. How is this specific business-related mortgage interest generally treated?

A. Generally entirely nondeductible, since interest on a loan secured by a personal residence is generally always treated as a nondeductible personal expense regardless of how the proceeds were actually used

B. Generally deductible only as an itemized deduction subject to the applicable overall acquisition debt principal limit, rather than as any form of allocable home office business expense

C. Generally deductible as a business expense allocable to the home office, rather than being limited to itemized treatment as personal qualified residence interest, since the loan proceeds funded a genuine business use

D. Generally deductible only at a specific reduced flat 50% rate of the interest actually paid, rather than being potentially fully deductible as an allocable home office business expense

**53.** A taxpayer claims a deduction for state and local sales tax paid during the year, rather than deducting state and local income tax, since the taxpayer resides in a state that imposes no state income tax at all. What is the general election available regarding this specific choice between sales tax and income tax?

A. Generally, a taxpayer may generally elect to deduct either state and local general sales tax or state and local income tax, but not both, with the combined amount still subject to the overall $10,000 cap

B. Generally, a taxpayer residing in a state with no income tax generally receives no state and local tax deduction at all, since only income tax generally qualifies for this specific deduction

C. Generally, a taxpayer may generally deduct both state and local sales tax and state and local income tax simultaneously in full, without any specific election required between the two

D. Generally, the election between sales tax and income tax generally is available only to a taxpayer who does not itemize deductions, rather than to an itemizing taxpayer

**54.** A taxpayer claims a deduction for the cost of a home security system installed specifically to protect a portion of the home used exclusively and regularly as a qualifying home office for the taxpayer's own business. How is the business-use portion of this specific home security system cost generally treated?

A. Generally entirely nondeductible, since a home security system is generally always treated as a nondeductible personal expense regardless of any underlying home office business use

B. Generally fully deductible in its entirety without any allocation at all, regardless of what percentage of the overall home is actually used for the qualifying home office

C. Generally deductible as a business expense allocable to the home office based on the business-use percentage of the home, similar to how other indirect home office expenses are generally allocated

D. Generally deductible only as an itemized deduction, rather than as any form of business expense properly allocable to the taxpayer's own home office business use

**55.** A taxpayer claims a deduction for legal fees paid in connection with obtaining a whistleblower award from the IRS, as discussed under Domain 2 regarding the taxability of the award itself. How are these specific attorney fees generally treated?

A. Generally deductible only as a miscellaneous itemized deduction subject to the same 2%-of-adjusted-gross-income floor that historically applied to most other unreimbursed employee-type expenses
B. Generally deductible as an above-the-line adjustment to income, up to the amount of the whistleblower award actually includible in the taxpayer's gross income for the year
C. Generally entirely nondeductible under current law, since attorney fees are generally always treated as a nondeductible personal expense regardless of the type of underlying award involved
D. Generally deductible only if the whistleblower award itself is entirely tax-exempt, rather than being deductible when the award is actually includible in the taxpayer's own taxable income

**56.** A taxpayer claims the Foreign Tax Credit for income tax actually paid to a foreign country on foreign-source income, rather than claiming an itemized deduction for that same foreign tax. What is the general advantage of electing the credit rather than the itemized deduction?

A. Generally, an itemized deduction generally reduces tax liability dollar for dollar, while a credit generally only reduces taxable income, the exact reverse of the actual general relationship
B. Generally, the two elections generally produce an identical tax benefit in every case, regardless of the taxpayer's own specific marginal tax rate for the year
C. Generally, the Foreign Tax Credit is generally available only to a taxpayer who does not itemize deductions at all, rather than existing as an alternative election
D. Generally, a credit generally reduces the taxpayer's own tax liability dollar for dollar, while an itemized deduction generally only reduces taxable income, making the credit generally more valuable in most cases

**57.** A taxpayer's total tax liability includes tax computed on income from an installment sale of investment real property, where the taxpayer elected installment method reporting rather than recognizing the entire gain in the year of sale. What is the general effect of this specific installment sale election?

A. Generally requires the taxpayer to recognize the entire gain immediately in the year of sale regardless of the installment election, since an installment election generally has no deferral effect

B. Generally allows the taxpayer to permanently exclude a portion of the gain from taxation entirely, rather than merely deferring recognition of that gain to a later year

C. Generally allows the taxpayer to recognize gain proportionally as each installment payment is actually received, rather than recognizing the entire gain immediately in the year of the original sale

D. Generally converts the character of the gain from capital gain to ordinary income, the exact reverse of the general character-preserving effect an installment election typically has

**58.** A taxpayer's total tax liability includes tax computed after applying a Section 1031 like-kind exchange to defer gain on the exchange of investment real property for other qualifying investment real property. What generally happens to the deferred gain when the taxpayer eventually sells the replacement property in an outright taxable sale?

A. Generally, the previously deferred gain is generally permanently forgiven and never becomes taxable at any later point, regardless of how or when the taxpayer eventually disposes of the replacement property

B. Generally, the previously deferred gain generally becomes taxable at that later time, since the replacement property generally carries over a reduced substituted basis reflecting the original deferred gain

C. Generally, the previously deferred gain generally becomes taxable only if the taxpayer sells the replacement property within exactly one year of the original like-kind exchange transaction

D. Generally, the previously deferred gain generally converts entirely to ordinary income upon the eventual sale, rather than continuing to be treated as capital gain from that later sale

**59.** A taxpayer's total tax liability includes tax computed on a distribution the taxpayer received from a nondeductible traditional IRA, where the taxpayer had previously made both deductible and nondeductible contributions to various traditional IRA accounts over the years. What general rule governs how the taxable and nontaxable portions of this distribution are determined?

A. Generally, the taxpayer may generally choose to treat the distribution as coming entirely from the nondeductible contributions first, making the entire distribution completely nontaxable regardless of other IRA balances

B. Generally, each individual traditional IRA account is generally treated entirely separately, meaning a distribution from the specific nondeductible account is generally always completely nontaxable

C. Generally, the taxable and nontaxable portions are generally determined solely by which specific account the distribution is actually taken from, rather than by any aggregate pro-rata calculation

D. Generally, the pro-rata rule generally requires aggregating all of the taxpayer's traditional IRA balances to determine the nontaxable percentage of any given distribution, rather than treating each account separately

**60.** A taxpayer's total tax liability reflects a computation involving the taxpayer's qualified business income deduction, where the taxpayer's pass-through business has significant W-2 wages paid to employees and a substantial amount of qualified property. What is the general purpose of the W-2 wage and qualified property limitation for a taxpayer above the applicable income threshold?

A. Generally limits the available deduction to the greater of a percentage of W-2 wages paid or a combination of a smaller percentage of W-2 wages plus a percentage of qualified property basis

B. Generally has no actual limiting effect at all on the deduction, since the 20% qualified business income deduction generally remains uncapped regardless of the taxpayer's own income level

C. Generally applies only to a specified service trade or business, with a non-specified-service trade or business generally being entirely exempt from any W-2 wage or property limitation

D. Generally converts the qualified business income deduction into a fully refundable credit once the taxpayer's income exceeds the applicable threshold, rather than continuing to function as any form of deduction

**61.** A taxpayer's total tax liability includes tax computed on income from a short sale of stock the taxpayer entered into and closed out within the same tax year, recognizing a gain on the transaction. How is this specific short sale gain generally characterized for holding period purposes?

A. Generally, a short sale gain is generally always treated as short-term capital gain in every case, regardless of how long the taxpayer actually held the shares used to close the position

B. Generally, a short sale gain is generally always treated as long-term capital gain in every case, regardless of how long the taxpayer actually held the shares used to close the position

C. Generally, the holding period for a short sale gain is generally determined by how long the taxpayer held the actual shares eventually used to close the short position, not by the duration the short position itself was open

D. Generally, a short sale gain is generally treated as ordinary income rather than as any form of capital gain, regardless of the taxpayer's own actual holding period for any shares involved

**62.** A taxpayer's total tax liability includes tax computed after recognizing a loss on worthless securities the taxpayer held in a taxable brokerage account, where the issuing company completely ceased operations and the stock became entirely worthless during the year. How is this specific worthless security loss generally treated?

A. Generally treated as an ordinary loss in every case, rather than as any form of capital loss, regardless of the character the security would have had if the taxpayer had actually sold it
B. Generally entirely nondeductible, since a worthless security loss is generally always treated as a nondeductible personal loss regardless of the underlying facts and circumstances involved
C. Generally treated as a casualty loss subject to the same $100 and 10%-of-adjusted-gross-income floors that generally apply to a personal casualty loss from a federally declared disaster
D. Generally treated as a capital loss as though the security were sold for zero on the last day of the tax year in which the security actually became completely worthless

**63.** A taxpayer's total tax liability includes tax computed after recognizing income from the cancellation of a nonbusiness credit card debt, where the taxpayer was not insolvent and did not file for bankruptcy at the time of the cancellation. How is this specific canceled debt generally treated?

A. Generally entirely tax-exempt, since a canceled credit card debt is generally always treated as a nontaxable event regardless of the taxpayer's own solvency or bankruptcy status
B. Generally fully taxable as ordinary income, reported on Form 1099-C by the creditor, since a debt cancellation generally results in taxable income absent an applicable specific statutory exclusion
C. Generally taxable only at the specific reduced flat 10% rate reserved specifically for canceled nonbusiness debt under current federal tax law, rather than at ordinary income tax rates
D. Generally treated as a capital loss to the taxpayer, rather than as any form of taxable ordinary income arising from the cancellation of the underlying debt

**64.** A taxpayer's total tax liability includes tax computed using the head of household filing status, and the taxpayer asks about the general qualification requirements for this specific filing status. What does a taxpayer generally need to establish to qualify as head of household?

A. Generally must be unmarried, or considered unmarried, as of December 31, have paid more than half the cost of maintaining the home, and have a qualifying person live with the taxpayer for more than half the year
B. Generally must simply be unmarried as of December 31, with no additional requirement at all regarding the cost of maintaining a home or the presence of any qualifying person

C. Generally must be married and filing a joint return with a spouse, the exact reverse of the actual marital status requirement generally applicable to head of household status
D. Generally must have at least two qualifying children living in the home, since a single qualifying child or other qualifying person generally never satisfies this specific filing status requirement

**65.** A taxpayer's total tax liability includes tax computed after recognizing a gain on the sale of a personal-use automobile the taxpayer sold for more than its original purchase price, an unusual result given typical vehicle depreciation. How is this specific gain generally treated?

A. Generally taxable as capital gain, since gain on the sale of personal-use property, though unusual for a vehicle, is generally taxable, unlike a loss on personal-use property, which is generally nondeductible
B. Generally entirely tax-exempt, since any gain on the sale of a personal-use vehicle is generally always excluded from taxation regardless of the specific sale price actually received
C. Generally treated as ordinary income rather than as any form of capital gain, regardless of how long the taxpayer actually owned the vehicle before the sale
D. Generally nondeductible and unreported, the same general treatment that would apply to a loss on the sale of that same personal-use vehicle under current law

**66.** A taxpayer's total tax liability includes tax computed after recognizing income under the original issue discount rules on a zero-coupon bond the taxpayer holds in a taxable brokerage account. How is this specific original issue discount generally treated for the bondholder?

A. Generally, the original issue discount generally is not taxable at all until the bond actually matures and the taxpayer actually receives the full face value payment in cash
B. Generally, the original issue discount generally must be included in the taxpayer's taxable income annually as it accrues, even though the taxpayer receives no actual cash payment until the bond matures
C. Generally, the original issue discount generally is taxed as capital gain rather than as ordinary interest income, unlike the accrued interest on a typical coupon-paying bond
D. Generally, the original issue discount generally is entirely tax-exempt, exactly the same treatment that generally applies to interest earned on a qualifying municipal bond

**67.** A taxpayer's total tax liability includes tax computed after recognizing a gain from the sale of a collectible, specifically a rare coin the taxpayer held for more than one year as a personal investment. How is this specific long-term collectible gain generally taxed compared to a long-term gain on ordinary corporate stock?

A. Generally taxed at the identical maximum 20% rate that generally applies to a long-term capital gain on ordinary corporate stock, with no distinction at all between the two types of asset

B. Generally taxed entirely at the taxpayer's own ordinary marginal income tax rate, rather than at any form of preferential long-term capital gain rate, unlike stock gain

C. Generally entirely tax-exempt, since a long-term gain on a collectible held as a personal investment is generally excluded from taxation under a specific statutory collectibles exclusion

D. Generally taxed at a maximum rate of 28%, a higher maximum specific rate than the 20% maximum rate that generally applies to a long-term gain on ordinary corporate stock

**68.** A taxpayer's total tax liability includes tax computed after applying the passive activity loss rules to a limited partnership interest in an oil and gas drilling program in which the taxpayer does not materially participate. What is the general treatment of a passive loss from this specific type of investment?

A. Generally, the passive loss remains fully deductible against the taxpayer's other nonpassive ordinary income without any limitation at all, regardless of the taxpayer's own lack of material participation

B. Generally, the passive loss is generally entirely nondeductible and permanently lost, with no carryforward of any kind available to offset any future year's passive or other income

C. Generally, the passive loss is generally deductible only against the taxpayer's other passive income, with any excess loss generally suspended and carried forward to offset passive income in a future tax year

D. Generally, the passive loss is generally deductible only against the taxpayer's own capital gain income, rather than against either passive activity income or nonpassive ordinary income

**69.** A taxpayer's total tax liability includes tax computed after recognizing depreciation recapture upon the sale of business equipment the taxpayer had previously depreciated using accelerated depreciation methods. How is this specific depreciation recapture generally characterized upon the sale?

A. Generally characterized entirely as capital gain, exactly the same treatment that generally applies to a gain on equipment that was never actually depreciated at all by the taxpayer

B. Generally characterized as ordinary income under Section 1245, to the extent of the previously claimed depreciation, with any remaining gain beyond that recaptured amount generally treated as capital gain

C. Generally characterized entirely as ordinary income for the full amount of the gain, regardless of whether that gain amount actually exceeds the previously claimed depreciation deduction

D. Generally characterized as an entirely tax-exempt recovery of the taxpayer's own prior depreciation deductions, rather than as either ordinary income or capital gain of any kind

**70.** A taxpayer's total tax liability includes tax computed after applying the excess business loss limitation to a large current-year business loss from the taxpayer's own sole proprietorship. What is the general effect of this specific limitation once the taxpayer's business loss exceeds the applicable threshold amount for the year?

A. Generally, the excess business loss beyond the applicable threshold is generally disallowed for the current year and is generally instead treated as a net operating loss carryforward to a future tax year
B. Generally, the excess business loss limitation generally has no effect at all on a sole proprietorship's loss, applying instead only to a loss from a partnership or S corporation
C. Generally, the excess business loss beyond the applicable threshold is generally permanently disallowed and lost entirely, with no carryforward of any kind available to a future tax year
D. Generally, the excess business loss limitation generally converts the disallowed excess loss into a nonrefundable tax credit, rather than continuing to be treated as any form of loss carryforward

**71.** A taxpayer's total tax liability includes tax computed after recognizing a gain on the sale of the taxpayer's principal residence that exceeds the applicable Section 121 exclusion amount available to the taxpayer's filing status. How is this specific excess gain, beyond the available exclusion, generally treated?

A. Generally entirely tax-exempt, since the Section 121 exclusion generally covers the entire gain on a principal residence sale regardless of the specific amount by which the gain exceeds the exclusion limit
B. Generally taxed entirely at the taxpayer's own ordinary marginal income tax rate, rather than at any form of preferential long-term capital gain rate, unlike other capital assets
C. Generally taxable as capital gain, generally long-term if the taxpayer owned the home for more than one year, subject to the applicable preferential capital gain tax rate on that specific excess portion
D. Generally treated as a nontaxable return of the taxpayer's own original home purchase price, rather than as any form of currently taxable gain beyond the available exclusion amount

**72.** A taxpayer's total tax liability includes tax computed after recognizing a distribution the taxpayer received from a nonqualified annuity purchased with after-tax funds, where the distribution includes both a return of the taxpayer's own original investment and taxable earnings. What general rule determines the taxable portion of this specific distribution?

A. Generally, the entire distribution is generally treated as a nontaxable return of the taxpayer's own original investment first, with taxable earnings only being taxed once that investment is fully recovered

B. Generally, the entire distribution is generally treated as fully taxable earnings first, with the taxpayer's own original investment only recovered tax-free once all earnings have been fully distributed

C. Generally, the entire distribution is generally taxed at a specific flat rate reserved for nonqualified annuities, rather than being allocated between nontaxable investment and taxable earnings at all

D. Generally, the exclusion ratio generally applies to determine what portion of each periodic annuity payment represents a nontaxable return of the taxpayer's own investment versus taxable earnings

**73.** A taxpayer's total tax liability includes tax computed after recognizing income from a Roth IRA distribution that fails to meet the requirements for a qualified distribution because the taxpayer has not yet satisfied the applicable five-year holding period, even though the taxpayer is over age 59½. What is the general ordering rule that applies to this specific nonqualified distribution?

A. Generally, earnings are generally treated as distributed first and are generally always fully taxable, with the taxpayer's own original contributions only recovered tax-free once all earnings are exhausted

B. Generally, the entire distribution is generally taxed as a single lump sum at the taxpayer's own ordinary income tax rate, without any specific ordering rule applying to the different components

C. Generally, contributions are generally treated as distributed first, tax-free, followed by conversion amounts, and finally earnings, which generally become taxable once the contribution and conversion amounts are fully exhausted

D. Generally, the ordering rule generally applies only to a traditional IRA distribution, and generally has no application at all to any type of Roth IRA distribution

**74.** A taxpayer's total tax liability includes tax computed after applying the excess Social Security tax withholding credit, where the taxpayer worked for two different employers during the year and had Social Security tax withheld by both, exceeding the applicable annual wage base maximum in total. What is the general remedy available for this specific overwithholding situation?

A. Generally, the taxpayer must generally request a refund directly and exclusively from each individual employer, rather than claiming any credit at all on the taxpayer's own individual income tax return

B. Generally, the excess amount withheld is generally permanently forfeited and lost entirely, with no credit or refund of any kind available to the taxpayer under current law

C. Generally, the excess amount withheld generally must be applied instead to reduce the taxpayer's own separate self-employment tax liability, rather than being claimed as any form of income tax credit
D. Generally, the taxpayer may generally claim the excess amount withheld beyond the annual maximum directly as a credit against income tax on the individual return, since neither employer knew of the other's withholding

**75.** A taxpayer asks a preparer for general guidance on the tax consequences of taking a home equity line of credit to purchase a rental property, rather than using cash savings for the down payment. What general tracing consideration would a preparer typically explain about deducting the resulting interest?

A. Generally explains that interest on a home equity line of credit is generally always treated as personal qualified residence interest, regardless of how the taxpayer actually uses the borrowed proceeds
B. Generally explains that interest deductibility generally follows the actual use of the loan proceeds under the interest tracing rules, meaning proceeds used for the rental generally produce rental-activity interest expense, not personal mortgage interest
C. Generally explains that interest tracing generally has no application at all to a home equity line of credit, unlike a traditional mortgage, which is generally always subject to tracing
D. Generally explains that the interest is generally entirely nondeductible in every case, since a home equity line of credit generally can never generate any deductible interest expense at all

**76.** A taxpayer asks a preparer for general guidance on the tax implications of naming a trust, rather than an individual, as the beneficiary of a traditional IRA. What general consideration would a preparer typically raise about this specific beneficiary designation?

A. Generally raises the consideration that the trust must generally meet specific applicable requirements to be treated as a see-through trust, allowing the underlying trust beneficiaries' own life expectancies to be used for distribution purposes
B. Generally raises no consideration at all, since naming a trust as beneficiary generally has no effect at all on the applicable distribution rules compared to naming an individual directly
C. Generally raises the consideration that naming a trust as beneficiary generally accelerates the entire IRA balance into immediate taxable income the moment the account owner actually dies
D. Generally raises the consideration that naming a trust as beneficiary generally converts the traditional IRA automatically into a Roth IRA, eliminating any future required distribution obligation entirely

**77.** A taxpayer asks a preparer for general guidance on the tax consequences of taking Social Security benefits early at age 62 versus delaying benefits until full retirement age or later. What general factor beyond the monthly benefit amount would a preparer typically raise?

A. Generally raises no consideration at all beyond the monthly benefit amount, since the specific claiming age generally has no other relevant tax or benefit-related effect on the taxpayer

B. Generally raises the consideration that claiming benefits early generally eliminates the possibility that any portion of the benefit will ever become taxable in any future year

C. Generally raises the consideration that claiming benefits early generally disqualifies the taxpayer permanently from ever again working in any capacity for the remainder of the taxpayer's life

D. Generally raises the consideration that claiming benefits early while still working can generally trigger a temporary earnings-based benefit reduction, in addition to the permanently reduced monthly benefit itself

**78.** A taxpayer asks a preparer for general guidance on the tax advantage of using a health savings account as a long-term retirement savings vehicle, rather than spending down the balance annually on current medical expenses. What general benefit would a preparer typically explain about this specific strategy?

A. Generally explains that HSA funds generally must be spent entirely within the same calendar year they are actually contributed, similar to the general use-it-or-lose-it rule that applies to certain flexible spending accounts

B. Generally explains that HSA funds can generally be invested and grown tax-deferred, and a taxpayer can generally reimburse a prior year's qualifying expense at any future date, effectively allowing long-term tax-free growth

C. Generally explains that using an HSA as a long-term savings vehicle generally provides no advantage at all compared to simply paying current medical expenses out of pocket each year

D. Generally explains that HSA funds generally lose their tax-advantaged status entirely once the taxpayer reaches age 65, regardless of whether the taxpayer ever actually withdraws any of the funds

**79.** A taxpayer asks a preparer for general guidance on the tax implications of a Roth IRA conversion ladder strategy used to access retirement funds before age 59½ without penalty. What general mechanism would a preparer typically explain about how this specific strategy works?

A. Generally explains that each year's Roth conversion generally must satisfy its own separate five-year waiting period before the converted principal can generally be withdrawn penalty-free, requiring the taxpayer to plan conversions several years in advance

B. Generally explains that a Roth conversion ladder generally allows immediate penalty-free access to converted funds the same year of conversion, with no waiting period of any kind applying

C. Generally explains that a Roth conversion ladder strategy is generally prohibited under current law, regardless of the taxpayer's own age or specific intended timeline for accessing the funds

D. Generally explains that a Roth conversion ladder generally applies only to a taxpayer already over age 59½, providing no meaningful benefit at all to a younger taxpayer

**80.** A taxpayer asks a preparer for general guidance on the tax consequences of paying off a low-interest-rate mortgage early using an inheritance received during the year, rather than investing the inherited funds instead. What general factor would a preparer typically identify as most relevant to this specific decision?

A. Generally identifies that paying off any mortgage early is always the clearly financially superior choice in every case, regardless of the mortgage's own specific interest rate

B. Generally identifies that investing the inherited funds is always the clearly financially superior choice in every case, regardless of the taxpayer's own specific mortgage interest rate

C. Generally identifies the comparison between the mortgage's own low after-tax interest cost and the taxpayer's own reasonably expected after-tax investment return, along with the taxpayer's own personal risk tolerance and liquidity needs

D. Generally identifies that this comparison involves no relevant tax consideration at all, since an inheritance is generally treated identically to any other source of investable funds

**81.** A taxpayer asks a preparer for general guidance on the tax consequences of establishing a health savings account eligible high-deductible health plan for the upcoming year, given the taxpayer's generally good health and low anticipated medical expenses. What general advantage would a preparer typically explain about this specific plan choice?

A. Generally explains that pairing the high-deductible plan with an HSA generally allows the taxpayer to make tax-deductible contributions, potentially resulting in lower overall combined premium and tax costs for a generally healthy taxpayer

B. Generally explains that a high-deductible health plan generally provides no tax advantage at all compared to a traditional lower-deductible plan, regardless of the taxpayer's own health status

C. Generally explains that only a taxpayer with significant ongoing medical expenses should ever consider a high-deductible health plan, since a generally healthy taxpayer would generally receive no benefit
D. Generally explains that establishing a high-deductible health plan generally disqualifies the taxpayer from ever claiming any other tax-advantaged retirement contribution in the same tax year

**82.** A taxpayer asks a preparer for general guidance on the tax consequences of exercising employee stock purchase plan rights to buy employer stock at a discount, and later selling the stock in a disqualifying disposition before meeting the applicable holding period. What general consequence would a preparer typically explain about this specific early sale?

A. Generally explains that a disqualifying disposition generally has no different tax consequence at all compared to a qualifying disposition, regardless of how long the taxpayer actually held the stock
B. Generally explains that a disqualifying disposition generally results in the entire sale proceeds being treated as a nontaxable return of the taxpayer's own original investment
C. Generally explains that a disqualifying disposition generally causes the original discount to be taxed as ordinary income in the year of sale, rather than receiving the more favorable treatment available for a qualifying disposition
D. Generally explains that a disqualifying disposition generally triggers self-employment tax on the sale proceeds, rather than continuing to be treated as any form of capital gain or ordinary income

**83.** A taxpayer asks a preparer for general guidance on the tax implications of setting up a spousal IRA for a nonworking spouse who has no earned income of the spouse's own for the year. What general rule would a preparer typically explain about this specific contribution?

A. Generally explains that a spousal IRA contribution is generally prohibited entirely whenever one spouse has no earned income of the spouse's own for the year, regardless of the couple's filing status
B. Generally explains that a spousal IRA contribution is generally permitted based on the working spouse's own earned income, provided the couple files a joint return, even though the nonworking spouse individually has no earned income
C. Generally explains that a spousal IRA contribution generally requires the nonworking spouse to have at least some minimal amount of the spouse's own earned income, even if quite small
D. Generally explains that a spousal IRA contribution is generally limited to half of the working spouse's own applicable IRA contribution limit, rather than to the same full individual limit

**84.** A taxpayer asks a preparer for general guidance on the tax consequences of timing the sale of a rental property to coincide with a year the taxpayer also has a large suspended passive loss carryforward from that same property. What general benefit would a preparer typically explain about this specific timing?

A. Generally explains that a suspended passive loss generally remains permanently restricted to offsetting only passive income, even upon a complete disposition of the underlying passive activity itself

B. Generally explains that selling the property generally has no effect at all on the taxpayer's ability to use any suspended passive loss carried forward from that specific property

C. Generally explains that a suspended passive loss generally expires and is forfeited entirely once the underlying passive activity that generated it is actually sold or otherwise disposed of

D. Generally explains that a complete disposition of the passive activity in a fully taxable transaction generally allows the taxpayer to deduct the entire suspended passive loss against any type of income in that year, not just passive income

**85.** A taxpayer asks a preparer for general guidance on the tax consequences of making a nondeductible contribution to a traditional IRA because the taxpayer's income exceeds the applicable deduction phase-out threshold while also being an active retirement plan participant. What general recordkeeping step would a preparer typically emphasize?

A. Generally emphasizes filing Form 8606 to track the nondeductible contribution basis, since failing to properly track this basis can generally result in the same funds being taxed twice upon eventual distribution

B. Generally emphasizes that no specific recordkeeping step at all is necessary, since the IRS generally automatically tracks a taxpayer's own nondeductible IRA contribution basis without any taxpayer action

C. Generally emphasizes that a nondeductible contribution generally should never actually be made in this specific situation, since the contribution would otherwise be entirely wasted with no tax benefit at all

D. Generally emphasizes converting the entire traditional IRA to a Roth IRA immediately, rather than filing any specific form to separately track the nondeductible contribution basis itself

**86.** A taxpayer asks a preparer for general guidance on the tax advantage of accelerating deductible business equipment purchases into the current tax year using bonus depreciation or Section 179 expensing, given an unusually high-income year for the taxpayer's own sole proprietorship. What general planning rationale would a preparer typically explain?

A. Generally explains that accelerating deductible equipment purchases generally provides no timing advantage at all, since the total lifetime deduction generally remains identical regardless of which specific year the purchase actually occurs

B. Generally explains that accelerating the deduction into the current high-income year generally allows the taxpayer to offset income taxed at a higher marginal rate, potentially generating a greater current tax benefit than spreading the deduction over several years

C. Generally explains that Section 179 expensing and bonus depreciation are generally available only to a corporation, with a sole proprietorship generally being entirely ineligible for either method

D. Generally explains that accelerating the deduction generally triggers immediate self-employment tax on the deducted amount, in addition to any income tax that might otherwise apply to that same amount

**87.** A taxpayer asks a preparer for general guidance on the tax consequences of relocating to a state with no state income tax shortly before exercising a large amount of vested but unexercised employer stock options. What general timing consideration would a preparer typically raise regarding this specific relocation?

A. Generally raises no consideration at all, since a taxpayer's state of residence at the specific moment of exercise generally is the only factor any state ever considers for this purpose

B. Generally raises the consideration that relocating to a state with no income tax generally eliminates all state tax exposure on the option income entirely, regardless of where the underlying services were performed

C. Generally raises the consideration that relocating to a different state generally has no effect at all on either the federal or the state tax treatment of the stock option exercise

D. Generally raises the consideration that state tax authorities generally may still attempt to tax income sourced to services performed while the taxpayer was still a resident of, or working within, the higher-tax state, even after the taxpayer's relocation

**88.** A taxpayer's individual income tax return reports a distributive share of loss from a general partnership in which the taxpayer actively and materially participates in the day-to-day management of the business. How is this specific general partner's distributive loss generally treated for self-employment tax purposes?

A. Generally, a general partner's distributive share is generally always excluded from self-employment tax computation, exactly the same treatment that generally applies to a limited partner's own distributive share

B. Generally, self-employment tax generally applies only to a distributive share of income, never to a distributive share of loss, regardless of the partner's own specific level of participation

C. Generally, the general partner's distributive share, whether income or loss, generally is included in net earnings from self-employment, since a general partner generally is treated as actively engaged in the partnership's trade or business

D. Generally, a general partner's distributive share generally is subject to self-employment tax only if the partnership actually made a cash distribution to that specific partner during the year

**89.** A taxpayer's individual income tax return reports income from a single-member LLC that elected to be taxed as an S corporation rather than remaining a disregarded entity by default. What form does this specific LLC generally file to report its own entity-level activity to the IRS?

A. Generally files Form 1065, the partnership return, exactly the same form generally required of a multi-member LLC that elects partnership taxation rather than S corporation taxation

B. Generally files Form 1120-S, the S corporation return, and generally issues the single owner a Schedule K-1 reporting that owner's own share of the entity's income, deduction, and credit items

C. Generally files no separate entity-level return at all, since a single-member LLC generally remains a disregarded entity regardless of any affirmative S corporation election actually made

D. Generally files Form 1040 directly, the same specific individual income tax return generally used by the single member, rather than filing any separate entity-level return

**90.** A taxpayer's individual income tax return must address income reported on a Schedule K-1 received late, after the taxpayer already filed the original return using estimated figures for that specific K-1 item. What is the general recommended course of action once the actual final Schedule K-1 is later received?

A. Generally recommends ignoring the late Schedule K-1 entirely, since a return once filed generally can never be amended regardless of any discrepancy in the underlying reported figures

B. Generally recommends automatically filing a new original return each time, rather than filing any amended return, regardless of how the actual final Schedule K-1 figures actually compare

C. Generally recommends contacting the partnership or S corporation to demand a corrected Schedule K-1, rather than ever comparing the actual figures to the taxpayer's own prior estimate

D. Generally recommends comparing the actual final Schedule K-1 figures to the originally estimated figures and generally filing an amended return using Form 1040-X if a material discrepancy actually exists

**91.** A taxpayer's individual income tax return reports income from a testamentary trust created under the terms of a decedent's own will, funded and activated only after the decedent's death. How does a testamentary trust generally differ from an inter vivos trust in terms of when the trust's separate income tax reporting obligation generally begins?

A. Generally, a testamentary trust and an inter vivos trust are generally functionally identical in every respect regarding when each trust's own separate income tax reporting obligation begins
B. Generally, an inter vivos trust generally does not become a separate taxable entity until the grantor's own death, exactly the same timing rule that generally applies to a testamentary trust
C. Generally, a testamentary trust generally does not become a separate taxable entity until the decedent's death actually occurs and the trust is actually funded, unlike an inter vivos trust, which generally exists and is funded during the grantor's own lifetime
D. Generally, a testamentary trust generally becomes a separate taxable entity immediately upon the will's own execution, well before the testator's own actual death ever occurs

**92.** A taxpayer's individual income tax return reports a distributive share of income from an S corporation, and the taxpayer also receives reasonable compensation as a wage-earning employee of that same S corporation. How is the taxpayer's wage compensation generally treated compared to the taxpayer's separate distributive share of S corporation income?

A. Generally, the wage compensation is generally subject to regular payroll tax withholding, including Social Security and Medicare tax, while the separate distributive share of S corporation income generally is not subject to self-employment tax
B. Generally, both the wage compensation and the distributive share of S corporation income are generally subject to identical payroll tax withholding treatment, with no meaningful distinction between the two types of income
C. Generally, the distributive share of S corporation income is generally subject to self-employment tax, while the taxpayer's own separate wage compensation generally is entirely exempt from any payroll tax withholding
D. Generally, neither the wage compensation nor the distributive share of S corporation income is generally subject to any payroll or self-employment tax under current law

**93.** A taxpayer's individual income tax return reports income earned by a qualified funeral trust established to prepay the taxpayer's own future funeral expenses. How is income earned within this specific type of trust generally treated for federal income tax purposes?

A. Generally, all income earned within a qualified funeral trust is generally entirely tax-exempt under current law, regardless of any election the trust's own trustee might otherwise make

B. Generally, income earned within a qualified funeral trust generally must always be reported directly on the individual beneficiary's own personal income tax return, with no separate trust-level election ever available

C. Generally, a qualified funeral trust is generally treated identically to a simple trust, requiring the trust's own income to be distributed annually and taxed to the trust's own beneficiary

D. Generally, the trust itself generally may elect to be treated as a separate taxpayer, filing its own return and paying tax on the trust's own income, rather than passing that income through to the individual beneficiary

**94.** A taxpayer's individual income tax return reports income earned as a member of the clergy, including a housing allowance the taxpayer's religious organization designated in advance for the year. How is this specific designated housing allowance generally treated for federal income tax purposes?

A. Generally excludable from income tax to the extent it does not exceed the taxpayer's actual housing expenses, though the allowance generally remains includible when computing the clergy member's own self-employment tax

B. Generally fully taxable for both income tax and self-employment tax purposes, exactly the same treatment that generally applies to a clergy member's own regular salary payment

C. Generally entirely tax-exempt for both income tax and self-employment tax purposes, since a clergy housing allowance is generally treated identically to any other tax-exempt fringe benefit

D. Generally excludable from self-employment tax computation entirely, though the allowance generally remains fully includible in the clergy member's own regular income tax computation

**95.** A taxpayer's individual income tax return reports a distributive share of income from a publicly traded partnership held in a taxable brokerage account, sometimes referred to as a master limited partnership. How does this specific type of investment generally differ from an ordinary corporate stock investment in terms of tax reporting complexity?

A. Generally, a publicly traded partnership generally issues the identical Form 1099-DIV that an ordinary corporate stock investment generally issues, with no meaningful reporting distinction between the two investment types

B. Generally, a publicly traded partnership generally requires no tax reporting at all by the individual investor, unlike an ordinary corporate stock investment, which always requires reporting any dividend received

C. Generally, a publicly traded partnership generally issues the investor a Schedule K-1 rather than a Form 1099-DIV, requiring the investor to report a distributive share of the partnership's own income, deduction, and credit items directly

D. Generally, a publicly traded partnership generally is taxed identically to a real estate investment trust, requiring the investor to report only ordinary dividend income rather than any distributive share

**96.** A taxpayer's individual income tax return reports income earned by a qualified disability trust established for the sole benefit of the taxpayer's own disabled adult child. What specific tax benefit does a qualified disability trust generally receive that an ordinary complex trust generally does not?

A. Generally, a qualified disability trust generally is entirely exempt from federal income tax in every case, unlike an ordinary complex trust, which generally remains fully subject to tax on its own income

B. Generally, a qualified disability trust generally is entitled to a personal exemption amount comparable to that of an individual taxpayer, rather than the much smaller personal exemption amount an ordinary complex trust generally receives

C. Generally, a qualified disability trust generally is taxed at the same preferential capital gain rate on all of its own income, rather than being subject to the compressed trust income tax rate brackets

D. Generally, a qualified disability trust generally receives an unlimited charitable contribution deduction, a specific benefit an ordinary complex trust generally does not receive under current law

**97.** A taxpayer's individual income tax return reports the taxpayer's own status as a resident alien for federal income tax purposes, determined under the substantial presence test based on the taxpayer's actual days present in the United States over a three-year period. What is the general effect of meeting this specific substantial presence test?

A. Generally, meeting the substantial presence test generally has no effect at all on the taxpayer's own federal tax residency status, regardless of the taxpayer's own actual physical presence pattern

B. Generally, meeting the substantial presence test generally results in the taxpayer being treated as a nonresident alien, the exact reverse of the actual general effect of satisfying this test

C. Generally, the taxpayer generally is treated as a resident alien for federal income tax purposes, generally taxed on worldwide income in the same general manner as a United States citizen
D. Generally, meeting the substantial presence test generally applies only to determine state tax residency, rather than having any bearing at all on federal income tax residency status

**98.** A taxpayer's individual income tax return reports income earned as an independent contractor for a company that also treats other similarly situated workers as common-law employees. What general factors does the IRS generally consider in determining whether the taxpayer is genuinely an independent contractor rather than a misclassified employee?

A. Generally considers behavioral control, financial control, and the type of relationship between the worker and the company, rather than relying on any single determinative factor alone
B. Generally considers only the specific label the company itself chooses to apply to the worker, regardless of the actual underlying facts and circumstances of the working relationship
C. Generally considers only whether the worker actually signed a written independent contractor agreement, regardless of how the actual day-to-day working relationship is genuinely conducted
D. Generally considers only whether the worker receives a Form 1099-NEC rather than a Form W-2, regardless of the actual underlying nature of the working relationship itself

**99.** A taxpayer's individual income tax return reports income from a qualifying widow or widower's household that includes a stepchild rather than the taxpayer's own biological or adopted child. Does a stepchild generally qualify as the dependent needed to support the qualifying surviving spouse filing status?

A. Generally no; only the taxpayer's own biological or legally adopted child generally may support the qualifying surviving spouse filing status, with a stepchild being entirely excluded from this specific status
B. Generally yes, but only if the taxpayer actually legally adopts the stepchild during the same year the qualifying surviving spouse filing status is actually claimed on the return
C. Generally no; a stepchild generally may support only the head of household filing status, and never the more specific qualifying surviving spouse filing status under any circumstance
D. Generally yes; a stepchild generally may qualify as the dependent needed to support the qualifying surviving spouse filing status, provided the other applicable requirements for that specific filing status are also satisfied

**100.** A taxpayer's individual income tax return reports a distributive share of income from an electing large partnership that chose simplified reporting rules available to certain qualifying large partnerships. How does receiving a Schedule K-1 from this type of partnership generally differ from receiving one from an ordinary small partnership?

A. Generally, an electing large partnership generally issues no Schedule K-1 at all to any of its own individual partners, unlike an ordinary small partnership, which always issues this specific form

B. Generally, the electing large partnership generally reports certain items on a more simplified, consolidated basis, reducing the number of separately stated items the individual partner generally must otherwise track and report

C. Generally, an electing large partnership generally requires each individual partner to file a wholly separate partnership return of the partner's own, rather than simply reporting a distributive share

D. Generally, an electing large partnership's own distributive share generally is entirely tax-exempt to each individual partner, unlike the fully taxable distributive share an ordinary small partnership generally passes through

## Answer Key and Explanations — Practice Exam 17

**1. A** — When a client's own stated characterization of an activity conflicts with the type of form received, a preparer generally should gather relevant facts, such as regularity, profit motive, and manner of operation, to make an informed determination, rather than simply accepting the client's own label without further inquiry into the underlying facts.

**2. D** — A preparer generally may rely on a client's own representation regarding home office square footage, provided the preparer asks reasonable follow-up questions and the figure does not appear implausible given the home's overall known size, consistent with the general due diligence standard of reasonable inquiry rather than independent verification of every client-provided fact.

**3. B** — Circular 230's competence standard generally requires a preparer to possess the necessary knowledge, skill, thoroughness, and preparation reasonably necessary for the specific matter, or to timely acquire the knowledge needed, or to associate with, or consult, another practitioner who possesses the necessary competence, before undertaking a new or unfamiliar type of engagement.

**4. C** — A preparer generally should advise a client who cannot complete a return by the original due date about the potential late-filing and late-payment penalty consequences, and about the availability of a filing extension, so the client can make an informed decision, since a filing extension generally does not extend the deadline for actually paying any tax owed.

**5. A —** The assessment statute of limitations generally limits how long the IRS has to assess additional tax after a return is filed, generally three years, while the Collection Statute Expiration Date generally limits how long the IRS has to collect an already-assessed tax liability, generally ten years from the date of assessment, two distinct periods governing different stages of the process.

**6. B —** A preparer generally must obtain the client's consent before using tax return information for a purpose other than preparing the return, including certain internal uses such as statistical compilation, since the applicable disclosure and use rules generally extend beyond simple third-party disclosure to cover internal uses without the taxpayer's own informed consent as well.

**7. D —** A Notice of Deficiency, commonly called a 90-day letter, generally notifies the taxpayer of the IRS's proposed tax adjustment and generally provides the taxpayer 90 days, or 150 days if the notice is addressed to a person outside the United States, to petition the United States Tax Court before the IRS actually assesses the additional proposed tax liability.

**8. C —** A preparer generally should first ask the client to attempt to locate supporting documentation for a security's cost basis, and where none is reasonably available, may generally rely on a reasonable, credible client statement, while recognizing this general limitation in the underlying support and advising the client accordingly regarding potential examination risk.

**9. D —** A Centralized Authorization File number, commonly called a CAF number, generally identifies a preparer's power of attorney and tax information authorization records within the IRS's internal system, generally streamlining future representation and information requests once a client's Form 2848 or Form 8821 has been processed and associated with that specific preparer's CAF number.

**10. B —** A preparer generally must maintain electronic records with reasonable safeguards, ensuring the records generally remain reasonably accessible and legible for the applicable retention period, a standard generally comparable to the one applied to paper records, since the underlying purpose of retention, supporting the accuracy of a filed return, generally does not depend on the specific record format used.

**11. A —** A preparer generally should advise a client whose share of a joint refund was entirely applied to the other spouse's separate past-due debt about the availability of injured spouse relief, since filing the applicable form may generally allow the client to recover the client's own separate share of the refund that was not actually attributable to the debt in question.

**12. C —** A preparer whose PTIN has expired due to a missed renewal generally may not lawfully prepare a federal tax return for compensation until the PTIN is actually renewed through the applicable annual IRS renewal process, since maintaining a valid, current PTIN generally is a prerequisite for any paid preparer to lawfully prepare a federal tax return.

**13. B —** Best practice generally recommends that a preparer disclose the fee structure, or at least a reasonable estimate, to the client before beginning work on the return, supporting transparency in the engagement and generally helping to avoid a later billing dispute or client dissatisfaction once the return is actually completed and the final fee is charged.

**14. D** — Form 8867 documents a paid preparer's due diligence in determining a client's eligibility for certain credits, including the Earned Income Tax Credit, the Child Tax Credit, and education credits, and must be completed by the preparer and filed with the return, or otherwise retained, since a failure to exercise due diligence can expose the preparer to a penalty.

**15. A** — Best practice generally recommends clearly documenting the engagement's scope in writing, and where state return preparation is excluded, generally advising the client that a separate state income tax filing obligation may still exist, helping to avoid a misunderstanding in which the client mistakenly assumes the preparer's engagement covered every applicable filing obligation.

**16. C** — A preparer who voluntarily completes the IRS's Annual Filing Season Program generally receives limited representation rights before the IRS, specifically regarding a return the preparer actually prepared and signed, a benefit an otherwise unenrolled preparer who does not participate in the program generally does not possess, though this remains more limited than the unlimited representation rights an Enrolled Agent holds.

**17. C** — Tip income a taxpayer receives directly from customers, and properly reports to the employer as required, is generally fully taxable as ordinary income, subject to regular income tax and generally subject to Social Security and Medicare tax withholding, in the same general manner as the taxpayer's other regular wages received from that same employer.

**18. D** — A distribution from a qualified annuity purchased entirely with pretax funds is generally fully taxable as ordinary income in the year actually received, since no portion of the original contribution represents the taxpayer's own after-tax basis, distinguishing this fully taxable distribution from a distribution involving basis recovery under the general annuity exclusion ratio rules.

**19. B** — A back pay award received through a wrongful termination lawsuit settlement, specifically compensating the taxpayer for lost wages, is fully taxable as ordinary wage income, since the award stands in the place of the wages the taxpayer would otherwise have earned, and the award remains subject to the same employment tax withholding that would have applied to those original wages.

**20. A** — A traditional IRA distribution used toward the purchase of a qualifying principal residence by a first-time homebuyer is generally excepted from the 10% early distribution penalty, up to an applicable lifetime dollar limit, though the distribution itself generally remains includible in the taxpayer's ordinary taxable income, since only the penalty, not the underlying tax, is excepted under this specific provision.

**21. D** — A state income tax refund is not taxable income under the tax benefit rule when the taxpayer claimed the standard deduction, rather than itemizing, in the year the underlying tax was paid, since the taxpayer received no federal tax benefit from deducting that state tax in the first place, distinguishing this nontaxable refund from one received by an itemizing taxpayer.

**22. B** — A reimbursement for employer-required safety equipment, properly substantiated under a genuine accountable plan meeting all applicable IRS requirements, is generally not includible in the employee's taxable wages, distinguishing this excludable reimbursement from an unsubstantiated payment made outside an accountable plan, which is generally fully taxable as ordinary wage income to the employee.

**23. A —** A cash prize won through a raffle, even one conducted by a nonprofit organization, is generally fully taxable as other income to the winner in the year actually received, regardless of the nonprofit status of the sponsoring organization, since winning a prize or award generally does not qualify for any specific statutory income tax exclusion under current federal law.

**24. C —** Upon exercising a nonqualified stock option, the taxpayer recognizes ordinary income equal to the bargain element, the excess of the stock's fair market value over the exercise price paid, and this amount is fully taxable as ordinary income at exercise, distinguishing this immediate taxation from the different, more favorable general treatment that can apply to an incentive stock option.

**25. D —** The earnings portion of a Coverdell Education Savings Account distribution used for a nonqualifying expense, unrelated to any genuine qualifying education cost, is generally taxable as ordinary income and generally subject to an additional 10% penalty tax, since the distribution does not meet the requirements to be treated as a qualified, tax-free education distribution under current law.

**26. A —** A state property tax rebate is generally not taxable income to the extent the taxpayer did not previously receive a federal tax benefit from deducting the underlying property tax, consistent with the general tax benefit rule, meaning a taxpayer who claimed the standard deduction, or otherwise received no benefit from the deduction, generally excludes the rebate from taxable income.

**27. B —** A length-of-service achievement award, given in the form of tangible personal property rather than cash, is excludable from the employee's taxable wages up to an applicable dollar limit, provided the award is given under a qualified, nondiscriminatory length-of-service award plan and the employee has completed the applicable minimum years of continuous service, required to be at least five years.

**28. C —** A lump-sum payment for unused accrued sick leave, paid upon a taxpayer's retirement, is generally fully taxable as ordinary wage income, subject to the same regular income tax withholding and employment tax treatment that generally applies to the taxpayer's other regular wages, since the payout generally represents deferred compensation for time the employee actually earned but did not use.

**29. A —** A traditional IRA distribution taken due to the birth or adoption of a child, within the applicable dollar limit for this qualified birth or adoption distribution, is excepted from the 10% early distribution penalty, though the distribution itself remains includible in the taxpayer's ordinary taxable income, with the option to later repay the distribution back into the IRA.

**30. C —** A traditional IRA distribution used to pay health insurance premiums during a qualifying period of unemployment, meeting the applicable specific statutory requirements, is generally excepted from the 10% early distribution penalty, though the distribution itself generally remains includible in the taxpayer's ordinary taxable income, since only the penalty, not the underlying tax, is excepted under this specific provision.

**31. D —** A genuine de minimis fringe benefit, such as an occasional holiday turkey or a modest gift item provided infrequently and of minimal value, is excludable from the employee's taxable wages, since the burden of accounting for such a minor benefit is unreasonable relative to its value, distinguishing it from a cash gift card, which is never treated as de minimis.

**32. B** — An HSA distribution used to pay Medicare premiums after the taxpayer reaches age 65 and enrolls in Medicare is generally entirely tax-exempt, since Medicare premiums generally qualify as a qualifying medical expense for this specific purpose, though the taxpayer generally can no longer make new contributions to the HSA once actually enrolled in Medicare.

**33. D** — An IRS whistleblower award is generally fully taxable as ordinary income to the recipient in the year actually received, generally reported on Form 1099-MISC, since the award generally represents compensation for information and services provided that led to the successful collection of unpaid tax, though the recipient generally may also deduct certain related attorney fees as an above-the-line adjustment.

**34. C** — A series of substantially equal periodic payments taken from a traditional IRA, meeting the applicable specific requirements, is generally excepted from the 10% early distribution penalty, provided the payments continue without modification for the required minimum period, generally the later of five years or until the taxpayer reaches age 59½, though the distributions themselves remain includible in ordinary taxable income.

**35. A** — A full refund of a security deposit the taxpayer originally paid to a landlord, returned upon move-out with no deductions taken, is generally not taxable income to the taxpayer, since the refund generally represents a nontaxable return of the taxpayer's own previously paid funds, rather than any form of income or gain to the recipient of the refund.

**36. B** — A distribution from a traditional 401(k) plan taken after a taxpayer separates from the sponsoring employer in or after the year the taxpayer turns age 55 is excepted from the 10% early distribution penalty under this plan-based exception, though the distribution remains includible in taxable income, an exception not available to an IRA distribution taken at that same age.

**37. C** — A cash contribution made directly to a private nonoperating foundation is generally limited to 30% of the taxpayer's adjusted gross income for the year, a lower percentage limitation than the 60% generally applicable to an equivalent cash contribution made to a qualified public charity, reflecting the generally more restrictive rules that apply to a private foundation contribution.

**38. A** — The itemized deduction for mortgage insurance premiums has historically been subject to periodic expiration and later legislative extension, so its general availability for a specific tax year generally depends on the current applicable statutory provision in effect for that year, making it important for a preparer to verify the deduction's status for the specific year the return actually covers.

**39. B** — When a taxpayer's primary reason for a nursing home stay is receiving necessary medical and nursing care, the entire cost, including the portion attributable to meals and lodging, is generally includible as a qualifying medical expense, a more favorable treatment than applies when the primary reason for the stay is instead personal or custodial rather than genuinely medical in nature.

**40. D** — When a refinanced loan combines original acquisition debt with a separate cash-out amount used for an unrelated purpose, such as paying off credit card debt, only the interest allocable to the original acquisition debt portion is deductible as qualified residence interest, while interest allocable to the cash-out portion used for a nonqualifying purpose is treated as nondeductible personal interest.

**41. C** — The American Opportunity Tax Credit is limited to a student's first four years of postsecondary education, and is unavailable once the student has already claimed the credit for four prior tax years, meaning a graduate student in a sixth year of overall postsecondary study is no longer eligible, though the Lifetime Learning Credit may still be available instead.

**42. D** — The cost of a capital improvement to a personal residence made for medical reasons, such as a wheelchair ramp recommended by a physician, is deductible as a medical expense only to the extent the cost exceeds any resulting increase in the home's fair market value, since only the excess portion represents a genuine medical, rather than capital, expenditure.

**43. B** — A personal casualty loss arising from a federally declared disaster is reduced by $100 per separate casualty event, and the combined total of all such losses for the year is then further reduced by 10% of the taxpayer's adjusted gross income, meaning only a loss exceeding both of these applicable floors actually generates a deductible itemized casualty loss.

**44. A** — An Armed Forces reservist's unreimbursed travel expense for traveling more than 100 miles from home to attend reserve duty is deductible as an above-the-line adjustment to income, up to the applicable federal per diem rate, available even to a taxpayer who claims the standard deduction, one of the limited exceptions still permitted for an unreimbursed employee-type expense.

**45. C** — The Saver's Credit calculation generally requires reducing the taxpayer's qualifying retirement contribution by any distribution taken by either the taxpayer or the taxpayer's spouse during the applicable testing period, generally the current year plus the two preceding years, meaning a spousal distribution can generally reduce or eliminate the credit otherwise available on a jointly filed return.

**46. A** — A taxpayer's gambling losses from licensed online sports betting are subject to the same rule that applies to any other form of gambling loss: deductible as an itemized deduction only up to the amount of the taxpayer's reported gambling winnings for the year, meaning the excess loss beyond winnings remains nondeductible regardless of the gambling platform or method involved.

**47. B** — When a qualified charity sells a donated vehicle worth more than $500 rather than using it for the charity's exempt purpose, the taxpayer's charitable deduction is limited to the gross proceeds the charity received from that sale, rather than to the vehicle's fair market value at donation, and the charity must provide written substantiation of this sale amount.

**48. D** — Continuing professional education required to maintain a self-employed taxpayer's existing professional license is deductible as an ordinary and necessary business expense directly on Schedule C, since the education maintains or improves skills required in the taxpayer's current trade or business, distinguishing this deductible maintenance-type education from education that instead qualifies the taxpayer for a new trade or business.

**49. B** — Under current law, a qualifying child must have a Social Security number valid for employment to generate the Child Tax Credit itself, meaning a child who instead has only an Individual Taxpayer Identification Number does not qualify for the Child Tax Credit, though that same child may still qualify the taxpayer for the smaller, nonrefundable Credit for Other Dependents instead.

**50. D** — For a charitable contribution made through payroll deduction, the combination of a pay stub, Form W-2, or other employer-furnished document showing the amount withheld, together with a pledge card or other document from the charity showing its name, generally satisfies the applicable substantiation requirement, an alternative to obtaining a separate formal receipt directly from the recipient charity itself.

**51. A** — The Earned Income Tax Credit generally includes an investment income limitation applicable to the taxpayer claiming the credit, meaning a taxpayer whose own investment income, such as interest, dividends, or capital gain, exceeds the applicable disqualifying threshold for the year generally becomes entirely ineligible for the credit, regardless of how modest the taxpayer's earned income might otherwise be.

**52. C** — Interest on a loan secured by the home but used exclusively to fund a genuine home office business addition is deductible as a business expense allocable to that home office use, rather than being limited to itemized treatment as personal qualified residence interest, since the use of the loan proceeds, not the type of collateral, governs the applicable deduction category.

**53. A** — A taxpayer may elect to deduct either state and local general sales tax or state and local income tax, whichever is greater, but not both, as part of the state and local tax itemized deduction, with the combined total, together with any deductible property tax, still subject to the same overall $10,000 aggregate cap that applies to this deduction category.

**54. C** — The cost of a home security system that protects the entire home, including a portion used exclusively as a qualifying home office, is deductible as a business expense allocable to the office based on the business-use percentage of the home, similar to how other indirect expenses, such as utilities or homeowners insurance, are allocated between personal and business use.

**55. B** — Attorney fees paid in connection with obtaining a taxable whistleblower award from the IRS are deductible as an above-the-line adjustment to income, up to the amount of the award includible in gross income, a favorable treatment that helps avoid the taxpayer being taxed on the gross award amount without any corresponding offsetting deduction for the related legal costs incurred.

**56. D** — Electing the Foreign Tax Credit is more advantageous than claiming an itemized deduction for the same foreign tax paid, since a credit reduces the taxpayer's tax liability dollar for dollar, while an itemized deduction only reduces taxable income, meaning the actual tax benefit of a deduction depends on and is limited by the taxpayer's own marginal tax rate.

**57. C** — Under the installment method, a taxpayer recognizes gain proportionally as each installment payment is received over the term of the sale, rather than recognizing the entire gain immediately in the year of sale, spreading the resulting tax liability across multiple years and preserving the underlying character of the gain as capital gain, provided the sold property was a capital asset.

**58. B** — When a taxpayer eventually sells replacement property acquired through a Section 1031 like-kind exchange in an outright taxable sale, the previously deferred gain generally becomes taxable at that time, since the replacement property generally carries over a reduced substituted basis from the original relinquished property, reflecting the specific amount of gain that was originally deferred through the like-kind exchange transaction.

**59. D** — The pro-rata rule generally requires a taxpayer with both deductible and nondeductible contributions across multiple traditional IRA accounts to aggregate all traditional IRA balances when determining the nontaxable percentage of any given distribution, computed using Form 8606, rather than allowing the taxpayer to select a specific account or ordering of contributions to determine the taxable portion of that distribution.

**60. A** — For a taxpayer above the applicable taxable income threshold, the qualified business income deduction is limited to the greater of 50% of the W-2 wages the business paid, or 25% of W-2 wages plus 2.5% of the unadjusted basis of qualified property, a limitation intended to target the deduction toward a business that employs workers or holds substantial capital assets.

**61. C** — The holding period for characterizing a gain from a short sale of stock is determined by how long the taxpayer held the shares eventually delivered to close out the short position, rather than by the duration the short position remained open, a somewhat counterintuitive rule requiring the holding period of the delivered shares rather than the short sale transaction dates.

**62. D** — A security that becomes completely worthless during the tax year is treated as though the taxpayer sold it for zero proceeds on the last day of that year, generating a capital loss, long-term or short-term depending on the holding period, subject to the same capital loss limitation rules that apply to any other capital asset.

**63. B** — Cancellation of a nonbusiness credit card debt is generally fully taxable as ordinary income to the taxpayer, generally reported on Form 1099-C by the creditor, since the discharge of indebtedness generally results in taxable income to the debtor absent an applicable specific statutory exclusion, such as insolvency or bankruptcy, neither of which applied in this specific taxpayer's situation.

**64. A** — To qualify for head of household filing status, a taxpayer must be unmarried, or considered unmarried, as of December 31, must have paid more than half the cost of maintaining a home for the year, and must have a qualifying child or other qualifying relative live with the taxpayer for more than half the year, subject to certain exceptions.

**65. A** — A gain on the sale of personal-use property, such as an automobile sold for more than its original cost, is taxable as capital gain, an asymmetric result compared to a loss on personal-use property, which is entirely nondeductible, reflecting the general principle that a gain on personal property is taxable while a corresponding loss receives no tax benefit at all.

**66. B** — The original issue discount on a zero-coupon bond must be included in taxable income annually as it accrues over the life of the bond, taxed as ordinary interest income, even though the taxpayer receives no cash payment until maturity, a phantom income situation the taxpayer should plan for since no cash is received to help cover the resulting tax liability.

**67. D** — A long-term capital gain on a collectible, such as a rare coin, art, or precious metal, held for more than one year is subject to a maximum 28% tax rate, higher than the 20% maximum rate that applies to a long-term gain on ordinary corporate stock or other typical capital assets, reflecting the collectibles gain rate category under current law.

**68. C** — A loss from a passive activity, such as a limited partnership interest in which the taxpayer does not materially participate, is deductible only against the taxpayer's other passive income for the year, with any excess passive loss suspended and carried forward indefinitely to offset passive income in a future year, or deductible upon complete disposition of the passive activity.

**69. B** — Upon the sale of depreciable business equipment, gain is characterized as ordinary income under the Section 1245 depreciation recapture rules, to the extent of the depreciation previously claimed on the equipment, with any remaining gain beyond that recaptured depreciation amount treated as capital gain, a ordering rule that prevents converting a depreciation deduction's tax benefit into a lower-taxed capital gain.

**70. A** — Once a taxpayer's current-year business loss exceeds the applicable statutory threshold for the taxpayer's filing status, the excess business loss beyond that threshold is disallowed for the current tax year and is instead treated as a net operating loss carryforward available to offset taxable income in a future year, subject to the net operating loss carryforward limitation rules.

**71. C** — Gain on the sale of a principal residence that exceeds the applicable Section 121 exclusion amount, $250,000 for a single taxpayer or $500,000 for a married couple filing jointly, is taxable as capital gain, long-term given the required two-year ownership and use test, and is subject to the applicable preferential capital gain rate on that excess portion.

**72. D** — For a nonqualified annuity purchased with after-tax funds, the exclusion ratio generally determines what portion of each periodic payment represents a nontaxable return of the taxpayer's own original investment versus taxable earnings, spreading the tax-free recovery of the investment proportionally across the expected payment stream, though a different rule generally applies to a nonperiodic, lump-sum-type withdrawal instead.

**73. C** — For a Roth IRA distribution that does not meet the qualified distribution requirements, a specific ordering rule generally applies: contributions are generally treated as distributed first, always tax-free, followed by any conversion amounts, and finally by earnings, which generally become taxable, and potentially penalized, only once the contribution and conversion amounts have been fully exhausted by the taxpayer's cumulative distributions.

**74. D** — When a taxpayer works for two or more employers during the year and the combined Social Security tax withheld exceeds the applicable annual maximum, the taxpayer may claim the excess amount directly as a credit against income tax on the individual return, since each employer withholds independently up to the maximum without knowledge of the taxpayer's other separate employment.

**75. B —** A preparer would explain that under the interest tracing rules, the deductibility and character of interest expense follows how the borrowed proceeds are used, meaning proceeds from a home equity line of credit used to purchase a rental property produce deductible rental-activity interest expense on Schedule E, rather than personal qualified residence interest subject to the home mortgage interest rules.

**76. A —** A preparer would raise the consideration that for a trust named as an IRA beneficiary to use the underlying trust beneficiaries' life expectancies, or the applicable ten-year rule, for distribution purposes, the trust must meet applicable requirements to qualify as a see-through trust, and would recommend the taxpayer work with an estate planning attorney to properly draft the trust document.

**77. D —** A preparer would generally raise the consideration that claiming Social Security benefits early, before full retirement age, while the taxpayer continues working can generally trigger a temporary earnings-based benefit reduction under the retirement earnings test, in addition to the permanently reduced monthly benefit amount itself, a combined effect the taxpayer should generally weigh against the value of receiving benefits sooner.

**78. B —** A preparer would explain that HSA funds can be invested and grown tax-deferred similar to a retirement account, and that a taxpayer can reimburse a prior year's substantiated qualifying medical expense at any future date, letting the HSA balance grow tax-free for many years while paying current medical costs out of pocket and saving the receipts for later reimbursement.

**79. A —** A preparer would explain that in a Roth conversion ladder strategy, each year's separate Roth conversion must satisfy its separate five-year waiting period before that converted principal amount can be withdrawn penalty-free, meaning a taxpayer must plan and execute conversions several years in advance of when access to the funds is needed to fully avoid the early distribution penalty.

**80. C —** A preparer would generally identify the comparison between the mortgage's own effective after-tax interest cost, particularly low if the rate is favorable, against the taxpayer's own reasonably expected after-tax investment return, along with the taxpayer's own personal risk tolerance and need for liquidity, as the most relevant general factors in weighing early mortgage payoff against investing an inheritance instead.

**81. A —** A preparer would generally explain that pairing a qualifying high-deductible health plan with an HSA generally allows a generally healthy taxpayer to make tax-deductible contributions to the HSA, potentially resulting in lower overall combined premium and tax costs compared to a traditional lower-deductible plan, while the HSA balance itself generally continues growing tax-deferred for future use, healthy year or not.

**82. C —** A preparer would explain that selling employee stock purchase plan shares in a disqualifying disposition, before satisfying the applicable holding period, causes the original purchase discount to be taxed as ordinary income in the year of sale, rather than receiving the more favorable treatment, including potentially reduced ordinary income recognition, available for a qualifying disposition meeting the longer holding period.

**83. B —** A preparer would explain that a spousal IRA contribution is permitted for a nonworking spouse based on the working spouse's earned income, provided the couple files jointly, allowing the nonworking spouse to contribute up to the same applicable annual IRA limit as the working spouse, even though the nonworking spouse has no earned income of their own for the year.

**84. D —** A preparer would explain that a taxpayer's complete disposition of a passive activity, such as selling a rental property, in a taxable transaction allows any suspended passive loss carryforward attributable to the property to become deductible against other income, not merely against passive income, unlocking a loss that had otherwise been restricted while the taxpayer still owned the activity.

**85. A —** A preparer would emphasize the importance of filing Form 8606 to track a taxpayer's nondeductible traditional IRA contribution basis, since failing to properly track this basis over the years can result in the same after-tax contributed funds being taxed a second time upon an eventual distribution, an easily avoidable but commonly overlooked recordkeeping failure among taxpayers making nondeductible contributions.

**86. B —** A preparer would explain that accelerating a deductible equipment purchase into a current unusually high-income year, using bonus depreciation or Section 179 expensing, allows the taxpayer to offset income taxed at a higher marginal rate, potentially generating a greater current-year tax benefit than spreading the same deduction gradually over the equipment's normal multi-year depreciation schedule instead.

**87. D —** A preparer would raise the consideration that a state the taxpayer is leaving may still attempt to tax a portion of the option income as sourced to services performed while the taxpayer was a resident of, or working within, that state, meaning relocating to a no-income-tax state before exercising options does not eliminate all prior-state tax exposure on that compensation.

**88. C —** A general partner's distributive share of partnership income or loss generally is included in the partner's net earnings from self-employment, since a general partner generally is treated as actively engaged in the partnership's trade or business, unlike a limited partner, whose distributive share is generally excluded from self-employment tax absent active participation in the partnership's management.

**89. B —** A single-member LLC that affirmatively elects S corporation tax treatment, rather than remaining a disregarded entity by default, generally files Form 1120-S, the S corporation return, reporting the entity's own overall income and expense, and generally issues the single owner a Schedule K-1 reporting that owner's own share, which the owner then reports on the owner's own individual Form 1040.

**90. D —** When a taxpayer files an original return using estimated figures for a Schedule K-1 not yet received, and the final K-1 later differs materially from the estimate, the recommended course of action is filing an amended return using Form 1040-X to correct the figures, ensuring the return accurately reflects the taxpayer's true distributive share of the entity's income or loss.

**91. C —** A testamentary trust, created under the terms of a decedent's will, does not come into existence as a separate taxable entity until the decedent's death occurs and the trust is funded through the probate process, unlike an inter vivos trust, which is created and funded during the grantor's lifetime and may begin its separate reporting obligation immediately upon funding.

**92. A —** A shareholder-employee's reasonable wage compensation from an S corporation is subject to regular payroll tax withholding, including Social Security and Medicare tax, while that same shareholder's separate distributive share of the S corporation's pass-through income is not subject to self-employment tax, a distinction that makes reasonable compensation an important area of IRS scrutiny for a closely held S corporation.

**93. D —** A qualified funeral trust, established to prepay a taxpayer's future funeral expenses, may elect to be treated as a separate taxpayer under a applicable election, filing its trust income tax return and paying tax on the trust's income at the trust level, rather than passing that income through to be taxed on the individual beneficiary's personal income tax return.

**94. A —** A properly designated clergy housing allowance is excludable from income tax to the extent it does not exceed the clergy member's actual housing expenses and the home's fair rental value, but the allowance remains includible when computing the clergy member's self-employment tax, a distinctive dual treatment that applies specifically to a minister or other qualifying member of the clergy.

**95. C —** An investment in a publicly traded partnership, sometimes called a master limited partnership, results in the investor receiving a Schedule K-1 rather than the simpler Form 1099-DIV an ordinary corporate stock investment generates, requiring the investor to report a distributive share of the partnership's income, deduction, and credit items, adding meaningfully more reporting complexity than an ordinary stock dividend.

**96. B —** A qualified disability trust, established for the sole benefit of a disabled individual, is entitled to a personal exemption amount comparable to that available to an individual taxpayer, a considerably larger exemption amount than the much smaller personal exemption an ordinary complex trust receives, reflecting a favorable provision intended to support a trust established for a disabled beneficiary's benefit.

**97. C —** A taxpayer who meets the substantial presence test, based on cumulative days present in the United States measured over a rolling three-year period using a weighted formula, is treated as a resident alien for federal income tax purposes, taxed on worldwide income in the same manner as a United States citizen, rather than being limited to United States-source income taxation.

**98. A —** The IRS generally applies a facts-and-circumstances test considering behavioral control, such as instructions and training provided, financial control, such as expense reimbursement and opportunity for profit or loss, and the type of relationship, such as written contracts and permanency, rather than relying on any single factor, including the worker's own label or the specific information return the company actually issues.

**99. D —** A stepchild may qualify as the dependent needed to support the qualifying surviving spouse filing status, provided the other applicable requirements, including maintaining a household for the child and the child meeting the applicable qualifying child requirements, are also satisfied, since the definition of a qualifying child for this purpose includes a stepchild alongside a biological or adopted child.

**100. B —** A partnership that elects the simplified reporting rules available to certain qualifying large partnerships reports certain items to its partners on a more simplified, consolidated basis on the resulting Schedule K-1, reducing the number of separately stated items a partner must otherwise track and report compared to the more detailed Schedule K-1 an ordinary small partnership issues.