PRACTICE EXAM 7: ENROLLED AGENT SEE PART 1 — INDIVIDUALS SIMULATION (100 QUESTIONS)

This simulation exam contains 100 multiple-choice questions covering all six domains of the IRS Special Enrollment Examination (SEE) Part 1: Individuals, weighted to mirror the official exam's domain distribution. Select the single best answer for each question. A complete answer key with explanations follows the exam. Recommended time: 3.5 hours.

1. A preparer's client presents a foreign passport as the sole form of identification, with no U.S.-issued Social Security card available, but a valid ITIN letter from the IRS. What should the preparer generally do with these specific identity documents?

A. Refuse to prepare the return since only a Social Security card satisfies identity requirements
B. Require the client to first apply for a Social Security number before any preparation begins
C. Treat the ITIN letter as invalid identification since it was issued by the IRS itself
D. Accept the passport plus the ITIN letter as adequate identity documentation for a taxpayer using an ITIN rather than an SSN

2. A preparer's client mentions during intake that they recently changed their legal name after marriage but have not yet updated their Social Security card to reflect the new name. What should the preparer generally advise regarding the name used on the return?

A. Use the new married name immediately regardless of what the SSA currently has on file
B. Use the name currently on file with the Social Security Administration until the client formally updates it, to avoid a processing mismatch
C. Use whichever name the client personally prefers with no regard to SSA records at all
D. Delay filing the return entirely until the SSA update is fully completed

3. A taxpayer's stepdaughter lived with the taxpayer and the taxpayer's spouse for the entire year, and the couple provided more than half of her support. The taxpayer's spouse is the stepdaughter's biological parent. Which dependency category generally applies to the stepdaughter?

A. Qualifying child, since a stepchild meets the relationship test on a joint return when a biological parent is also a filer

B. Qualifying relative only, since a stepchild never meets the qualifying child relationship test

C. No dependency category applies since the taxpayer is not the biological parent

D. Qualifying widow, since the taxpayer's spouse is the biological parent

4. A preparer discovers that a client's prior-year return claimed the American Opportunity Credit for a dependent who was actually a graduate student pursuing a fifth year of coursework beyond the four-year limit. What should the preparer generally recommend?

A. Ignore the prior-year error since amended returns rarely change the overall outcome

B. Simply continue claiming the American Opportunity Credit again on the current-year return

C. Recommend amending the prior-year return to remove the improperly claimed credit and, if eligible, substitute the Lifetime Learning Credit instead

D. Advise the client that graduate coursework is always eligible regardless of prior years claimed

5. A client's Form 1099-K shows total transactions exceeding the client's actual gross receipts reported on Schedule C, due to the platform including refunded transactions in the gross total. How should the preparer generally handle this specific discrepancy?

A. Report the full 1099-K figure exactly as shown with no adjustment for refunds

B. Ignore the 1099-K entirely since platform-reported totals are inherently unreliable

C. Reconcile the 1099-K total against the client's own actual records, adjusting for refunds, to report the correct net business income

D. Report only the difference between the two figures as the client's taxable income

6. A preparer's new client cannot recall whether a prior-year Recovery Rebate Credit was actually received or already reconciled on that prior return. Which resource would most directly help the preparer confirm this specific detail?

A. The client's current employer's payroll department records

B. An IRS account transcript showing the taxpayer's actual payment history

C. The client's current bank statement showing recent account activity

D. A blank current-year Form 1040 instruction booklet

7. A taxpayer's adult son and his wife both lived with the taxpayer for the entire year, and the couple files jointly solely to claim a refund of withheld tax, with neither spouse owing any tax if filing separately. Can the taxpayer still claim the son as a dependent?

A. Yes, since the joint return test includes a specific exception when filing jointly is solely to claim a withholding refund

B. No, any dependent who files a joint return is automatically disqualified with no exceptions

C. Yes, but only if the daughter-in-law is also independently claimed as a dependent

D. No, since a married adult child can never qualify as anyone else's dependent

8. A preparer's client wants a trusted advisor to have full authority to sign the client's tax return and negotiate directly with the IRS on the client's behalf during an ongoing audit. Which specific form generally grants this broader authority?

A. Form 8821, Tax Information Authorization, which only allows access to confidential information

B. Form W-9, used to request a taxpayer identification number

C. Form 4506, used to request a copy of a previously filed return

D. Form 2848, Power of Attorney and Declaration of Representative, which grants full representation authority before the IRS

9. A preparer's client insists their adult sibling qualifies as a dependent despite the sibling earning $9,000 in wages during the year, exceeding the qualifying relative gross income limit for the year. What should the preparer generally advise?

A. The sibling can still be claimed since siblings are exempt from the gross income test

B. The sibling cannot be claimed as a dependent, since the sibling's income exceeds the qualifying relative gross income limit

C. The sibling can be claimed as long as the taxpayer provided more than half of their support

D. The gross income test only applies to unrelated individuals, never to a sibling

10. A preparer's client asks whether occasional cash tips received directly from customers, never reported to the employer and with no Form W-2 reflecting them, must still be reported as taxable income. What should the preparer generally advise?

A. No, unreported cash tips are exempt from taxation since no employer reporting occurred

B. Only tips exceeding $20 per month in total require any reporting at all

C. Tips are taxable only if the employer separately confirms receiving the report

D. Yes, all tip income is generally taxable and reportable regardless of whether it was reported to the employer or shown on any form

11. A preparer's client asks whether a same-sex spouse validly married in a foreign country that recognizes same-sex marriage can be claimed as a spouse for U.S. federal filing purposes, given the couple currently resides in the United States. What should the preparer generally advise?

A. Yes, a marriage validly performed under the law of the foreign country of celebration is generally recognized for federal tax purposes

B. No, only a marriage performed within the United States is ever recognized federally

C. Yes, but only if the couple also holds a separate U.S. marriage certificate

D. No, foreign same-sex marriages require special IRS pre-approval before being recognized

12. A preparer discovers that a client's dependent, previously claimed as a full-time student, actually withdrew from school after only two months of the current year and did not re-enroll. What is the preparer's general obligation regarding this specific discovery?

A. Automatically continue claiming the dependent under student status without any further inquiry

B. Automatically drop the dependent entirely without evaluating any other applicable qualifying tests

C. Evaluate whether the dependent still meets the qualifying child tests without student status

D. Ignore the discovery since it only affects one specific test among several

13. A taxpayer's mailing address on the current return differs from the address used on a previously submitted Form W-4 filed with the employer earlier in the year. What is the general significance of this specific discrepancy for return preparation purposes?

A. It automatically disqualifies the taxpayer from claiming any dependents on the current return

B. It requires the taxpayer to file an amended prior-year return before proceeding

C. It changes the taxpayer's filing status eligibility for the current tax year

D. It generally has limited direct significance for the return itself, since the return's own address controls IRS correspondence going forward

14. A preparer's client asks whether documentation showing consistent monthly rental income deposits into a personal bank account, without any formal lease agreement in writing, is sufficient to establish reportable rental income for return preparation purposes. What should the preparer generally advise?

A. No, rental income can never be reported without an accompanying written lease agreement

B. Yes, bank records showing a consistent rental income pattern can generally help substantiate reportable rental income even absent a written lease

C. No, informal cash rental arrangements are entirely exempt from any tax reporting requirement

D. Yes, but only if the total rent collected exceeds $25,000 for the entire year

15. A preparer's client asks whether claiming Head of Household status is appropriate when the client's only qualifying person is a parent who does not live with the client but for whom the client pays more than half the cost of maintaining a separate home. What should the preparer generally advise?

A. Head of Household is unavailable since the qualifying person must always live with the taxpayer

B. Head of Household requires the parent to also be claimed as a full dependent on a separate return

C. Head of Household is generally still available for a parent, since a parent is the one qualifying relative who need not actually live with the taxpayer

D. Head of Household is available only if the parent's home is located within the same state

16. A preparer's client wants to know whether a licensed CPA, enrolled agent, or attorney representing the client automatically has authority to receive the client's tax refund directly into the representative's own bank account. What should the preparer generally advise?

A. No, a representative's authority under Form 2848 generally does not include the authority to receive the client's refund directly into their own account

B. Yes, any licensed representative automatically has this specific authority once Form 2848 is filed

C. Yes, but only an attorney specifically has this particular authority among the three professions

D. No representative of any kind may ever discuss the client's refund status with the IRS

17. A taxpayer's employer-sponsored qualified adoption assistance program pays $8,000 toward legal fees and agency costs for an ongoing adoption, within the applicable annual exclusion limit for this benefit. How is this employer payment generally treated for the employee?

A. Generally excluded from taxable income up to the applicable annual exclusion limit

B. Fully includible in taxable wages regardless of the applicable exclusion limit

C. Taxable only above a separate flat $3,000 threshold each year

D. Treated as self-employment income rather than as an employer-provided benefit

18. A taxpayer's traditional 403(b) plan required minimum distribution is calculated incorrectly by the plan's third-party administrator, resulting in an underpayment for the year. What excise tax generally applies to the resulting shortfall if not corrected under available IRS relief provisions?

A. A flat $1,000 penalty regardless of the actual size of the RMD shortfall

B. A 25% excise tax on the amount of the RMD shortfall not timely distributed, potentially reduced to 10% if promptly corrected

C. No penalty applies since the administrator, not the taxpayer, caused the specific error

D. A 50% excise tax applies with no reduced-rate correction option available at all

19. A taxpayer sells a work of fine art held for four years for a $9,000 gain, correctly classified as long-term gain under the collectibles holding period rule. What maximum federal rate generally applies to this specific type of long-term gain on collectibles?

A. 20%, the standard top rate applied to most other types of long-term capital gain

B. 15%, the standard middle rate applied to most other types of long-term capital gain

C. 37%, the top ordinary income tax rate applied to short-term capital gain

D. 28%, the special maximum rate that applies specifically to long-term gain on collectibles like fine art

20. A taxpayer's traditional pension survivor annuity, continuing after the original pensioner's death, is received by an adult child beneficiary rather than a surviving spouse. How is the child's basis recovery in this annuity generally treated compared to a surviving spouse's treatment?

A. The child beneficiary starts with an entirely new, unrelated basis calculation of their own

B. The entire survivor annuity becomes automatically fully taxable with no further basis recovery ever allowed

C. The child beneficiary generally continues recovering any of the original pensioner's remaining unrecovered basis, similar to how a surviving spouse would recover it

D. Only a surviving spouse, never any other type of beneficiary, may recover any remaining basis

21. A taxpayer's employer pays $700 toward the taxpayer's qualified student loan balance directly under a qualifying employer educational assistance program, comfortably within the combined annual $5,250 exclusion limit shared with other educational assistance benefits. How is this specific payment generally treated?

A. Excluded from the employee's taxable income, since it falls within the program's combined annual exclusion limit for educational assistance benefits

B. Fully includible in taxable wages regardless of the applicable combined exclusion limit

C. Taxable only above a separate flat $200 minimum threshold each year

D. Treated as a taxable loan to the employee rather than as a benefit payment

22. A taxpayer's brokerage account reports a $7,000 long-term capital gain and a separate $9,000 short-term capital loss from unrelated securities sold during the same tax year. How is the net result of these two transactions generally treated for the year?

A. Short-term losses and long-term gains can never be netted against each other at all

B. The short-term loss first offsets the long-term gain, leaving a $2,000 net short-term capital loss remaining for the year

C. The full $9,000 loss remains entirely separate from the $7,000 long-term gain

D. Only $3,000 of the loss may ever be netted against any capital gain amount

23. A taxpayer's employer withholds and pays for a $250 gym membership as part of a general employee wellness benefit, available to all employees regardless of health status. How is this specific fringe benefit generally treated under current federal law?

A. Entirely excluded from income under a currently active permanent statutory exclusion

B. Excluded only up to a $500 annual cap set specifically for wellness benefits

C. Treated as a nontaxable working condition fringe benefit regardless of the amount

D. Currently taxable and includible in the employee's wages, since gym membership benefits generally lack a specific statutory exclusion under current law

24. A taxpayer receives a $1,800 reward from a private company for reporting a security vulnerability discovered through the company's bug bounty program. How is this specific reward generally treated for the recipient's own federal tax purposes?

A. Fully includible in the recipient's gross income as ordinary taxable income for the year received

B. Entirely tax-exempt, since it originates from a private company rather than a government agency

C. Taxable only if the reward amount exceeds a specific statutory dollar threshold

D. Treated as capital gain income rather than as ordinary income for the recipient

25. A taxpayer's traditional annuity contract's interest rate combines a guaranteed minimum rate with an additional variable rate tied to an underlying market index, both credited annually to the account's cash value. For federal tax purposes, how is this combined credited interest generally treated when eventually distributed?

A. Only the guaranteed minimum-rate portion is taxable, with the variable portion excluded

B. Only the variable, index-linked portion is taxable, with the guaranteed portion excluded

C. Treated entirely as ordinary taxable income upon distribution, regardless of the guaranteed or variable components making up the total credited rate

D. Treated as long-term capital gain rather than as ordinary income upon distribution

26. A taxpayer's traditional IRA custodian charges a one-time account transfer fee, deducted directly from the IRA's own account balance rather than paid separately by the taxpayer using outside funds. How is this specific fee generally treated for tax purposes?

A. Treated as a taxable distribution equal to the amount of the fee deducted

B. Deductible above the line as a separate adjustment to the taxpayer's own income

C. Treated as an additional nondeductible IRA contribution for the year the fee is charged

D. Generally not treated as a taxable distribution, since the fee is paid using IRA funds rather than being separately deducted by the taxpayer

27. A taxpayer's employer-sponsored qualified bicycle commuting reimbursement benefit, historically excluded from taxable wages up to a specific monthly limit, is currently suspended under current federal law for most employees. How is a bicycle commuting reimbursement generally treated under current law?

A. Entirely excluded from income under a currently active permanent statutory exclusion

B. Currently taxable and includible in wages, since the exclusion has been suspended

C. Excluded only up to a reduced $20 monthly cap under current law

D. Treated as a nontaxable working condition fringe benefit regardless of the amount

28. A taxpayer's traditional IRA distribution is used entirely to satisfy IRS-required substantially equal periodic payments under the Section 72(t) exception, calculated using one of the IRS-approved methods, before the taxpayer reaches age 59½. How is the 10% early distribution penalty generally treated for these specific payments?

A. The penalty always applies regardless of whether the payments follow an IRS-approved method

B. The penalty applies at a reduced 5% rate rather than being fully waived

C. The penalty does not apply if the taxpayer continues payments for the required minimum duration

D. The exception applies only once the taxpayer has already reached age 59½

29. A taxpayer's Series HH savings bond, an older bond type no longer issued but still held by some taxpayers, pays semiannual interest directly to the bondholder rather than accruing internally like a Series EE bond. How is this semiannual interest generally treated for tax purposes?

A. Entirely tax-exempt since it originates from a U.S. government savings bond

B. Taxable only above a specific annual interest income threshold each year

C. Fully includible as ordinary taxable interest income in the year each semiannual payment is actually received by the bondholder

D. Deferred entirely until the bond eventually reaches its final maturity date

30. A taxpayer's employer provides a $1,500 tuition reduction benefit for the taxpayer's own graduate-level coursework taken at the employer's affiliated university, distinct from the separate employer educational assistance exclusion. How is a qualified tuition reduction benefit generally treated for an employee of an educational institution?

A. Fully includible in taxable wages regardless of the specific qualified tuition reduction rules

B. Taxable only above a separate flat $500 minimum threshold each year

C. Treated as self-employment income rather than as an employer-provided fringe benefit

D. Generally excluded from the employee's taxable income under the specific qualified tuition reduction rules for employees of educational institutions

31. A taxpayer's traditional pension distribution is subject to mandatory 20% federal withholding because the taxpayer received the distribution directly rather than as a trustee-to-trustee rollover. How does this mandatory withholding generally affect the taxpayer's actual tax liability calculation for the year?

A. The withholding represents an entirely separate, additional tax on top of the taxpayer's regular liability

B. The withholding is credited against the taxpayer's total tax liability, similar to wage withholding

C. The withholding has no bearing whatsoever on the taxpayer's total tax liability calculation

D. The withholding permanently forfeits that portion of the distribution regardless of actual tax owed

32. A taxpayer's employer-provided qualified moving expense reimbursement, paid to a member of the Armed Forces on active duty moving pursuant to permanent change of station orders, exceeds the taxpayer's actual substantiated moving costs by $600. How is this specific excess reimbursement generally treated?

A. The $600 excess above actual substantiated moving costs is generally includible in the service member's taxable wages

B. The entire reimbursement, including the excess, remains entirely excluded from taxable income

C. The excess is treated as a nontaxable loan the service member must eventually repay

D. The excess automatically reduces the service member's future reimbursement eligibility instead

33. A taxpayer's brokerage account reports a $2,000 qualified dividend from a foreign corporation eligible for treaty benefits, alongside a separate $2,000 ordinary dividend from a domestic corporation that does not meet the required holding period for qualified treatment. How are these two dividend amounts generally treated?

A. Both dividends receive identical preferential qualified dividend tax treatment regardless of holding period

B. Both dividends are taxed entirely at the taxpayer's ordinary marginal income tax rate

C. Only the domestic dividend is includible in the taxpayer's gross income at all

D. The foreign dividend generally receives preferential qualified dividend rates, while the domestic dividend, lacking the required holding period, is taxed at ordinary rates

34. A taxpayer's traditional IRA rollover from a former employer's SIMPLE IRA plan, held for less than two years since the taxpayer's first SIMPLE contribution, is rolled over directly into a traditional IRA rather than another SIMPLE IRA. How is this specific early rollover generally treated?

A. Treated as a tax-free rollover identical to rolling over from any other traditional IRA

B. Generally treated as a fully taxable distribution subject to a 25% additional tax, since the two-year SIMPLE IRA holding requirement was not yet satisfied

C. Subject only to the standard 10% early distribution penalty rather than the enhanced 25% penalty

D. Entirely tax-exempt since the funds are simply moving between two different IRA accounts

35. A taxpayer's traditional IRA distribution is used entirely to pay for the taxpayer's own qualified higher education expenses, including tuition and required fees, at an eligible institution. How is the 10% early distribution penalty generally treated for this specific type of distribution?

A. The distribution becomes entirely tax-free, avoiding both the penalty and income tax

B. The exception applies only if the education expenses are for a dependent, not the taxpayer

C. The penalty does not apply to the extent used for qualified higher education expenses, though still taxable

D. No penalty exception exists for higher education expenses under current federal law

36. A taxpayer's employer provides a $300 annual subscription to a financial wellness and budgeting app as part of a general employee benefits package available to all employees. How is this specific digital benefit generally treated for the employee's own tax purposes?

A. Fully includible in the employee's taxable wages, since this type of digital subscription benefit generally lacks a specific statutory exclusion under current law

B. Entirely excluded from income since it directly relates to the employee's financial wellbeing

C. Excluded up to a $150 threshold, with only the remainder treated as taxable

D. Treated as a nontaxable working condition fringe benefit regardless of the subscription cost

37. A taxpayer's charitable contribution of a personal-use vehicle valued at $8,000 is donated directly to a qualified charity, which keeps and actually uses the vehicle for its own charitable operations rather than selling it. How is this specific contribution generally treated for deduction purposes?

A. Deductible at the vehicle's full fair market value, since the charity's significant intervening use, rather than a resale, allows fair-market-value treatment

B. Deductible only at the vehicle's original purchase price regardless of the charity's actual use

C. Entirely nondeductible, since vehicle donations never qualify for any charitable deduction

D. Deductible only at half of the vehicle's current fair market value

38. A taxpayer's Child Tax Credit calculation involves a qualifying child who was born during the current tax year, on July 15. How does this specific mid-year birth generally affect the child's Child Tax Credit eligibility for the year of birth?

A. The credit is prorated based on the number of months the child was actually alive

B. The child does not qualify until the following tax year after a full year of life

C. The child fully qualifies for the credit for the entire year, since the age test only requires being under age 17 as of December 31

D. The child qualifies only for a partial credit calculated based on days alive

39. A taxpayer's traditional IRA contribution deduction is calculated for a taxpayer who is self-employed and also separately contributes to a solo 401(k) plan through the same self-employment activity. Does contributing to a solo 401(k) generally count as active participation affecting traditional IRA deductibility?

A. No, a solo 401(k) never counts as active participation since the taxpayer is self-employed

B. Yes, contributing to a solo 401(k) plan generally counts as active participation, subjecting the taxpayer's traditional IRA deduction to the applicable phase-out

C. Yes, but only if the solo 401(k) also received a separate employer contribution that year

D. No, active participation applies only to a plan sponsored by an unrelated employer

40. A taxpayer's Lifetime Learning Credit is claimed for a single course taken at a community college purely for personal enrichment, unrelated to the taxpayer's current job or any career path. Does the personal-enrichment nature of the course generally disqualify it from the credit?

A. Yes, only coursework directly connected to the taxpayer's current job ever qualifies

B. Yes, the credit requires enrollment in a program leading to a recognized credential

C. No, but only if the course is taken at a four-year accredited institution

D. No, the Lifetime Learning Credit does not require the coursework be job-related, degree-related, or connected to any specific career path

41. A taxpayer's residential energy-efficient exterior door replacement costs $2,500 and qualifies for the Energy Efficient Home Improvement Credit at 30%, subject to a specific $250 per-door annual cap, with a separate $500 aggregate cap across all doors replaced in the same year. How is the credit generally calculated for a single door costing $2,500?

A. $250, the applicable per-door cap, since 30% of the $2,500 door cost would otherwise substantially exceed that specific per-door cap

B. $750, the full 30% of the $2,500 door cost with no cap applied

C. $2,500, the full cost of the door with no percentage applied at all

D. $500, using the aggregate cap rather than the applicable per-door cap

42. A taxpayer's traditional IRA contribution deduction is being calculated for a taxpayer who is not an active participant in any employer retirement plan and whose spouse is also not an active participant in any employer plan. Is the traditional IRA contribution generally fully deductible regardless of the couple's income level?

A. No, the deduction still phases out based on income even when neither spouse actively participates

B. Only half of the contribution is deductible when neither spouse is an active participant

C. No deduction is available at all unless at least one spouse actively participates

D. Yes, when neither spouse is an active participant in any employer plan, the traditional IRA deduction is generally fully available regardless of the couple's income level

43. A taxpayer's Premium Tax Credit reconciliation on Form 8962 shows the taxpayer's household income came in below 100% of the federal poverty line at year-end, despite an accurate initial Marketplace estimate that placed the household above that threshold when coverage was purchased. How is this specific outcome generally treated?

A. The taxpayer must repay the entire advance credit received, since actual income fell under the poverty line

B. The Marketplace enrollment is automatically retroactively voided due to the specific income shortfall

C. The taxpayer generally remains eligible for the Premium Tax Credit under a specific rule protecting a good-faith estimate that reasonably placed the household above the poverty line at enrollment

D. No credit of any kind is ever available once actual income falls under the poverty line

44. A taxpayer's traditional IRA excess contribution correction includes not only the excess principal amount but also the earnings attributable to that excess, both withdrawn together before the extended filing deadline. How are the withdrawn earnings specifically treated for the year of the original contribution?

A. The attributable earnings are entirely tax-free since they resulted from an excess contribution correction

B. The attributable earnings are includible in the taxpayer's taxable income for the year the excess contribution was originally made, not the year of the actual withdrawal

C. The attributable earnings are includible in income for the year the withdrawal actually occurred instead

D. The attributable earnings convert automatically into a separate nondeductible IRA contribution

45. A taxpayer's Child and Dependent Care Credit calculation involves care provided by the taxpayer's own adult child, age 22, who is not claimed as the taxpayer's dependent. Is payment to this adult child generally eligible for the credit calculation, assuming all other requirements are otherwise met?

A. Yes, payment to an adult child who is not the taxpayer's dependent and is not a qualifying person under age 19 can generally qualify for the credit

B. No, payment to any relative of the taxpayer is always disqualified from the credit calculation

C. Yes, but only if the adult child is separately licensed as a professional childcare provider

D. No, only payment to an entirely unrelated third-party provider ever qualifies for this credit

46. A taxpayer's traditional IRA deduction is calculated for a taxpayer whose modified AGI falls exactly at the very bottom edge of the applicable phase-out range for an active plan participant. How is the deductible contribution amount generally treated at this exact bottom-edge income point?

A. The deduction is immediately and entirely eliminated the moment the phase-out range technically begins

B. Exactly half of the contribution becomes deductible at this specific bottom-edge income point

C. The full contribution generally remains deductible at the very bottom edge of the phase-out range

D. The deduction depends solely on the taxpayer's total number of dependents at this income level

47. A taxpayer's traditional IRA contribution for a taxpayer with $95,000 of net self-employment earnings, reduced to $88,290 after the deduction for one-half of self-employment tax, is being calculated for eligibility purposes. Which specific figure generally represents the taxpayer's usable earned income for IRA contribution limit purposes?

A. The full $95,000 figure, before any reduction for self-employment tax

B. The $88,290 figure, representing net self-employment earnings after the deduction for one-half of self-employment tax

C. A flat $50,000 figure regardless of the taxpayer's actual specific earnings

D. Zero, since self-employment earnings never count as usable earned income

48. A taxpayer's Retirement Savings Contributions Credit eligibility is based on a $4,000 contribution to a Roth IRA, exceeding the $2,000 maximum eligible contribution amount used to calculate this specific credit. How is the excess $2,000 above that maximum generally treated for credit calculation purposes?

A. The excess amount doubles the applicable credit rate percentage used in the calculation

B. The excess amount disqualifies the entire contribution from generating any credit whatsoever

C. The excess amount is instead applied toward the following year's credit calculation

D. The excess $2,000 above the credit's own $2,000 maximum eligible contribution amount simply does not factor into the credit calculation at all

49. A taxpayer's traditional IRA rollover from a former employer's 401(k) plan is completed as a direct trustee-to-trustee transfer into a Roth IRA rather than into another traditional IRA, converting pretax funds in the process. How is this specific direct Roth conversion generally treated for tax purposes?

A. The converted amount is generally includible in taxable income for the year, despite the direct transfer

B. Entirely tax-free since it was completed as a direct trustee-to-trustee transfer

C. Subject to the 10% early distribution penalty in addition to ordinary income tax

D. Deferred entirely until the taxpayer eventually withdraws funds from the new Roth IRA

50. A taxpayer's traditional IRA deduction is disallowed for the current year because the taxpayer's earned income for the year was $0, despite the taxpayer having significant investment income and rental income during the year. What is the general reason this specific IRA contribution deduction is disallowed?

A. Investment and rental income actually always count fully as compensation for IRA contribution purposes

B. The deduction is disallowed only because the taxpayer's total income exceeds a specific ceiling

C. IRA contributions generally require compensation, meaning earned income from working, rather than investment or rental income, which does not count toward this specific requirement

D. The deduction is disallowed because the taxpayer failed to itemize deductions for the year

51. A taxpayer's mortgage interest deduction includes interest on a home equity loan used entirely to pay off a prior first mortgage in a straightforward cash-neutral refinance, with no additional cash taken out beyond the original mortgage balance. How is the interest on this specific refinance loan generally treated?

A. Entirely nondeductible, since the loan is technically structured as a home equity loan

B. Deductible only as a miscellaneous itemized deduction subject to a 2% floor

C. Deductible only up to half of the interest, since it is technically a refinance

D. Fully deductible as acquisition debt interest, since proceeds simply replaced the original acquisition debt

52. A taxpayer's Child and Dependent Care Credit calculation for one qualifying child under age 13 uses actual care expenses of $2,500, under the $3,000 cap that applies for one qualifying person. Applying a 30% credit rate based on the taxpayer's AGI, what is the resulting credit for the year?

A. $900, using an incorrect calculation applying 30% to the $3,000 cap rather than actual expenses

B. $750, calculated as 30% applied to the full $2,500 in actual qualifying expenses, since that amount falls under the applicable $3,000 cap

C. $2,500, the full expense amount with no percentage rate applied at all

D. $1,250, using an incorrect 50% rate rather than the applicable 30% rate

53. A taxpayer's traditional IRA contribution deduction is affected by the taxpayer's spouse having actively participated in an employer retirement plan for only a portion of the year before that plan was terminated mid-year. How does this partial-year active participation generally affect the deduction phase-out determination?

A. Only a full twelve months of active participation triggers any deduction phase-out at all

B. The phase-out is prorated based on the exact number of months the plan was actually active

C. Active participation for even a portion of the year generally still triggers active participant status for that entire year, subjecting the deduction to the applicable phase-out

D. Partial-year active participation has no bearing at all on the deduction phase-out determination

54. A taxpayer's American Opportunity Credit calculation includes $4,500 of qualified tuition expenses, under the 100%-of-first-$2,000-plus-25%-of-next-$2,000 credit formula. Applying this specific formula, what is the maximum available credit for these particular expenses?

A. $4,500, the full expense amount with no formula-based limitation applied at all

B. $1,125, using an incorrect flat 25% rate applied to the entire $4,500 amount

C. $2,000, using only the first tier of the formula and disregarding the second tier entirely

D. $2,500, calculated as 100% of the first $2,000 plus 25% of the next $2,000 in qualifying expenses, disregarding the remaining $500

55. A taxpayer's traditional IRA rollover contribution, representing funds that were previously distributed from another IRA and properly rolled over within the required 60-day window, does not count against the taxpayer's own separate annual contribution limit. What is the general reason a properly completed rollover contribution is treated this way?

A. Rollover contributions are actually always counted fully against the annual contribution limit like any other contribution

B. A rollover contribution simply moves the taxpayer's existing retirement funds between accounts rather than representing genuinely new money being contributed for the year

C. The exception applies only to a rollover completed as a direct trustee-to-trustee transfer

D. The exception applies only if the taxpayer is also over the standard retirement age

56. A taxpayer itemizes deductions and includes $6,000 of unreimbursed medical expenses on Schedule A, after applying the applicable AGI-based floor. The taxpayer's AGI for the year is $60,000, and total unreimbursed qualifying medical expenses before any floor were $10,500. What is the deductible amount?

A. $6,000, calculated as $10,500 in total qualifying expenses minus $4,500 (7.5% of the $60,000 AGI floor)

B. $10,500, the full amount of qualifying medical expenses with no AGI floor applied at all

C. $4,500, applying only the floor amount itself rather than subtracting it from total expenses

D. $1,500, using an incorrect 10% AGI floor rather than the applicable 7.5% floor for medical expenses

57. A married couple filing jointly has taxable income of $95,000, all from ordinary wage income, in a tax year using the standard progressive bracket structure. Which method correctly computes their federal income tax liability?

A. Apply the single marginal rate corresponding to the top bracket their income reaches to the couple's entire $95,000 of taxable income

B. Apply the lowest marginal bracket rate to the entire $95,000 amount, since it is the couple's first dollar of taxable income

C. Apply each progressively higher marginal rate only to the specific slice of income falling within that bracket, summing the tax owed across all brackets up to $95,000

D. Divide the $95,000 by the number of brackets crossed and apply an averaged rate to the full amount

58. A single taxpayer has $3,000 of qualified dividend income and otherwise falls within the 22% ordinary marginal tax bracket for the year. How is this qualified dividend income generally taxed?

A. At the taxpayer's applicable long-term capital gains rate, typically 15% given this income level, rather than at the 22% ordinary rate

B. At the taxpayer's full 22% ordinary marginal tax rate, identical to wage income

C. Entirely tax-free regardless of the taxpayer's other income or bracket

D. At a flat 37% rate reserved specifically for all dividend income

59. A taxpayer's Alternative Minimum Tax (AMT) calculation begins with regular taxable income, which is then adjusted by adding back certain preference items and adjustments before applying the separate AMT exemption and rate structure. What is the general purpose of this parallel calculation?

A. To fully replace the regular tax system for all taxpayers regardless of income level or preference items

B. To ensure taxpayers with substantial preference items still pay a minimum level of tax overall

C. To provide an alternative, generally lower tax liability option that taxpayers may elect whenever advantageous

D. To apply exclusively to corporations and never to individual taxpayers under current law

60. A taxpayer sold a rental property held for eight years, recognizing $40,000 of gain, of which $12,000 represents previously claimed depreciation subject to unrecaptured Section 1250 treatment. How is this $12,000 portion generally taxed?

A. At the taxpayer's full ordinary income tax rate, identical to short-term gain treatment

B. Entirely tax-free, since depreciation recapture on real property was eliminated under current law

C. At the flat 28% collectibles rate applicable to all depreciable property

D. At a maximum federal rate of 25%, higher than standard long-term capital gains rates

61. A taxpayer's net investment income for the year is $30,000, and modified AGI is $220,000, exceeding the $200,000 single-filer threshold for the Net Investment Income Tax (NIIT) by $20,000. How is the 3.8% NIIT calculated in this situation?

A. 3.8% is applied to the lesser of net investment income or the amount MAGI exceeds the threshold, here the smaller $20,000 excess

B. 3.8% is applied to the full $30,000 of net investment income regardless of how much MAGI exceeds the threshold

C. 3.8% is applied to the full $220,000 of modified AGI without regard to the threshold at all

D. 3.8% is applied only to the $200,000 threshold amount itself

62. A taxpayer's Qualified Business Income (QBI) deduction calculation involves taxable income before the QBI deduction that falls well below the applicable threshold for specified service trade or business limitations. What is the general QBI deduction available in this situation?

A. No QBI deduction is available at all regardless of income level under current law

B. A flat 37% deduction applied uniformly to all qualified business income regardless of the taxpayer's income level

C. Generally the lesser of 20% of qualified business income or 20% of taxable income minus capital gain

D. The full amount of qualified business income is deductible with no percentage limitation whatsoever

63. A self-employed taxpayer's net earnings from self-employment for the year total $80,000. How is the Self-Employment Tax generally calculated on this amount under current law?

A. 15.3% is applied directly to the full $80,000 with no adjustment factor applied first

B. The tax is calculated at a flat 7.65% rate identical to the employee-only FICA withholding rate

C. No self-employment tax applies at all since the taxpayer has no employer withholding wages

D. 15.3% is applied to 92.35% of net self-employment earnings, up to the applicable Social Security wage base, combining the Social Security and Medicare tax components

64. A taxpayer's total tax liability for the year, after applying all credits, is $18,000, while the taxpayer's total withholding and timely estimated payments for the year equal $15,500. How does this shortfall generally affect the taxpayer's filing?

A. No penalty can ever apply as long as the full balance due is paid by the original filing deadline

B. The taxpayer may owe an estimated tax underpayment penalty in addition to the $2,500 balance due, unless a safe harbor exception applies

C. The shortfall is automatically forgiven whenever it is under $5,000 for the year

D. The IRS automatically converts any underpayment into an interest-free extended payment plan

65. A taxpayer's long-term capital loss for the year totals $8,000, while the taxpayer has no capital gains at all for the year. How much of this loss may generally be deducted against ordinary income this year, with any remainder carried forward?

A. The full $8,000 is deductible against ordinary income in the current year with no annual limitation

B. None of the loss is deductible in the current year or any future year without offsetting capital gains

C. $3,000 may be deducted against ordinary income this year, with the remaining $5,000 carried forward to future years

D. $5,000 may be deducted this year, with the remaining $3,000 carried forward

66. A taxpayer's Form 1040 return reflects total tax liability of $12,000 and total tax payments, including withholding and estimated payments, of $14,200 for the year. What is the general result of this $2,200 difference?

A. The taxpayer owes an additional $2,200 balance due with the return

B. The $2,200 excess must be forfeited entirely rather than refunded or applied forward

C. The excess automatically becomes a nondeductible contribution to the taxpayer's retirement account

D. A $2,200 refund is generally due to the taxpayer, reflecting the excess of total payments over total tax liability for the year

67. A dependent child's unearned income for the year, consisting entirely of interest and dividend income from a custodial account, exceeds the applicable threshold for the Kiddie Tax rules to apply. How is the excess unearned income generally taxed under these rules?

A. At the child's own marginal tax rate regardless of how much the unearned income exceeds the threshold

B. At the parent's marginal tax rate rather than the child's own generally lower marginal rate

C. At a flat 37% rate applied uniformly regardless of either parent's or the child's own bracket

D. Entirely tax-free, since it belongs to a dependent child rather than the parents directly

68. A taxpayer's Schedule D calculation nets a $6,000 long-term capital gain against a $2,000 short-term capital loss for the year, after each category was separately netted internally first. What is the general federal tax treatment of the resulting $4,000 net gain?

A. The $4,000 net gain retains its character as long-term capital gain, eligible for preferential long-term capital gains rates

B. The $4,000 net gain is treated entirely as ordinary income with no preferential rate available

C. The $4,000 net gain is treated entirely as short-term capital gain taxed at ordinary rates

D. The gain and loss cannot be netted against each other across the short-term and long-term categories at all

69. A taxpayer's total itemized deductions for the year are $9,000, while the applicable standard deduction for the taxpayer's filing status is $14,600. Which approach should generally be used when preparing this taxpayer's return?

A. The itemized deductions, since they are always the more accurate reflection of the taxpayer's actual expenses

B. An average of the standard deduction and itemized deductions, split evenly between the two

C. The standard deduction, since it exceeds the taxpayer's total itemized deductions and produces a lower taxable income

D. Neither deduction may be claimed since the itemized total falls under the standard deduction amount

70. A taxpayer exercises incentive stock options during the year, creating a positive AMT adjustment for the bargain element between the exercise price and fair market value, even though no regular income tax is triggered by the exercise itself. What is the general effect of this adjustment?

A. The bargain element is fully excluded from both regular tax and AMT calculations entirely

B. The bargain element is added back for AMT purposes, potentially triggering AMT liability even though it is not taxable for regular income tax purposes upon exercise

C. The bargain element triggers regular income tax immediately upon exercise, just as it does for AMT

D. AMT adjustments never apply to incentive stock option exercises under any circumstances

71. A taxpayer's total federal tax liability calculation includes both regular income tax and self-employment tax from a sole proprietorship. Which of these two tax components generally allows a corresponding above-the-line deduction for a portion of the amount paid?

A. Regular income tax itself allows a full deduction for the amount paid in the following year's return

B. Neither self-employment tax nor regular income tax allows any corresponding deduction under current law

C. Self-employment tax allows a full 100% deduction for the entire amount paid, not merely half

D. Self-employment tax allows a deduction for one-half of the amount paid, taken as an adjustment to income above the line

72. A taxpayer's total tax return reflects a $5,000 general business credit and a $3,000 nonrefundable dependent-related credit, applied against a $6,500 total tax liability before credits, with credits generally applied up to but not below zero. What is the general result?

A. The credits reduce tax liability to zero, but any excess nonrefundable credit amount beyond that point is generally not refunded, though some credits may carry forward

B. The full $8,000 combined credit amount is refunded regardless of the taxpayer's actual $6,500 liability

C. Nonrefundable credits automatically convert into a cash refund once liability reaches zero

D. Only one of the two credits may be claimed at all in the same tax year

73. A taxpayer's total tax due for the year includes a calculated $1,200 additional tax from early distribution penalties on a retirement account withdrawal that did not qualify for any penalty exception. Where does this additional 10% penalty generally appear on the taxpayer's return?

A. As a reduction to the taxpayer's regular income tax liability rather than an addition to it

B. As an addition to the total tax liability on Schedule 2, added to the taxpayer's regular income tax rather than replacing it

C. As a separate refundable credit rather than an additional tax owed

D. The penalty is never actually reported on the return itself, only assessed separately by the IRS after filing

74. A taxpayer's total income for the year includes $2,000 of tax-exempt municipal bond interest, which is excluded from taxable income but still reported on the return. What is the general reason this tax-exempt interest is still reported despite not being taxed?

A. It is reported purely for informational purposes and has absolutely no effect on any other calculation on the return

B. It is actually fully taxable and the term tax-exempt is a misnomer under current federal law

C. It must be reported only if the taxpayer also itemizes deductions rather than claiming the standard deduction

D. It is used in several other calculations, such as determining the taxable portion of Social Security benefits and certain phase-out thresholds, even though it is not itself subject to income tax

75. A client asks a tax practitioner for a written recommendation regarding a tax position with a reasonable basis but not substantial authority, and the client has not been informed of potential penalty exposure. What does Circular 230 generally require regarding disclosure of this position?

A. The practitioner must generally advise the client of any opportunity to avoid penalties through adequate disclosure and the requirements for that disclosure

B. The practitioner has no obligation at all to discuss potential penalties with the client under Circular 230

C. The practitioner must refuse to prepare the return entirely whenever any penalty exposure exists

D. The practitioner must report the client's position directly to the IRS before filing the return

76. A tax practitioner discovers, after a client's return has already been filed, that the client omitted a substantial amount of income from a prior year's return that is still open under the statute of limitations. What does Circular 230 generally require the practitioner to do?

A. Immediately amend the prior return without first informing the client of the error at all

B. Ignore the omission entirely, since it relates only to a prior year's already-filed return

C. Promptly advise the client of the error and the consequences of not correcting it, without unilaterally disclosing it to the IRS without the client's consent

D. Report the client directly to the IRS Whistleblower Office without any further client communication

77. A client is considering whether to make quarterly estimated tax payments to avoid an underpayment penalty, given a significant increase in self-employment income this year compared to the prior year. What safe harbor generally protects against an underpayment penalty regardless of the current year's actual liability?

A. Paying any amount at all in estimated payments, regardless of the specific percentage of either year's liability

B. Paying at least 100% of the prior year's total tax liability (110% if prior-year AGI exceeded $150,000) through timely estimated payments and withholding

C. Waiting until the filing deadline to pay the full balance due, since estimated payments are never actually required

D. Paying exactly 50% of the current year's actual final tax liability, calculated only at filing time

78. A client asks whether contributing to a traditional 401(k) plan through payroll deferral versus contributing to a Roth 401(k) option offered by the same employer produces a materially different long-term outcome. What is the key distinction a practitioner should generally explain?

A. There is no meaningful difference at all between the two options since both are simply retirement account contributions

B. Roth 401(k) contributions are always limited to a much lower annual dollar amount than traditional deferrals

C. Traditional deferrals reduce current taxable wages with taxation deferred until withdrawal, while Roth deferrals are made with after-tax dollars but qualified withdrawals are generally tax-free

D. Only traditional 401(k) contributions are eligible for any employer matching contribution at all

79. A client is comparing the tax treatment of a Health Savings Account (HSA) against a general-purpose Flexible Spending Account (FSA) offered under the same employer's cafeteria plan. What is a key structural difference a practitioner should generally explain?

A. HSA funds generally roll over indefinitely and remain the owner's property, unlike most FSA funds

B. Both accounts function identically with no meaningful structural differences in ownership or carryover rules

C. FSA funds always roll over indefinitely while HSA funds must generally be used within the same plan year

D. Neither account type allows any funds to roll over to a subsequent year under any circumstances

80. A client asks a practitioner whether it is generally advisable to withdraw funds from a traditional IRA before age 59½ to pay off a high-interest personal credit card balance. What should the practitioner generally advise regarding this specific strategy?

A. The withdrawal would be completely tax-free and penalty-free regardless of the client's age or purpose

B. The withdrawal would only be subject to the 10% penalty but never subject to ordinary income tax at all

C. IRA funds may never be withdrawn for any non-retirement purpose under any circumstances whatsoever

D. The withdrawal would generally be subject to both income tax and the 10% early distribution penalty

81. A client asks whether bunching multiple years of charitable contributions into a single tax year, rather than spreading them evenly, could produce a tax benefit given the client's itemized deductions are currently close to the standard deduction amount. What is the general strategy being described?

A. Concentrating deductible expenses into alternating years can push total itemized deductions above the standard deduction in the bunched year while taking the standard deduction in other years

B. Bunching contributions has no effect at all on whether itemizing produces any benefit in any year

C. The strategy requires making the exact same contribution amount every single year with no variation

D. Bunching only applies to mortgage interest payments and can never apply to charitable contributions

82. A client, age 45, wants to know the general tax consequence of converting funds from a traditional IRA to a Roth IRA in the current year, given the client expects to be in a significantly higher tax bracket in future years. What should the practitioner generally explain about this conversion?

A. The conversion is entirely tax-free in the year it occurs, with no income inclusion required at all

B. The converted amount is generally includible in taxable income, but future qualified withdrawals are tax-free

C. The conversion automatically triggers the 10% early distribution penalty regardless of the client's age

D. Roth conversions are only permitted for taxpayers who are already over age 59½

83. A client operating a small business as a sole proprietor asks whether forming an S corporation could reduce the client's overall Self-Employment Tax burden compared to continuing as a sole proprietorship, given consistent, substantial net profit each year. What is the general tax planning concept being described?

A. S corporation status has no effect at all on how any portion of business profit is taxed for employment tax purposes

B. Sole proprietorship profit is never subject to any self-employment tax under current law

C. An S corporation allows the owner to take a reasonable salary subject to payroll tax, with remaining profit distributed as a distribution generally not subject to self-employment tax, unlike sole proprietorship profit

D. S corporation shareholders are required to pay self-employment tax on 100% of all business profit regardless of salary

84. A client asks a practitioner to prepare a return taking a position the practitioner believes lacks even a reasonable basis, purely to generate a larger refund the client requested. What does Circular 230 generally require the practitioner to do in this situation?

A. Prepare the return exactly as the client requests, since client instructions always override the practitioner's own professional judgment

B. Prepare the return but add a personal disclaimer statement rather than declining to take the position

C. File the return anyway and simply notify the IRS afterward that the position was requested by the client

D. Decline to sign or prepare the return with that position, since a practitioner may not take a position lacking a reasonable basis

85. A client asks whether increasing Form W-4 withholding allowances immediately after having a large balance due this year is a reasonable strategy going forward. What should a practitioner generally explain about this approach?

A. W-4 adjustments have no effect at all on the amount of tax ultimately withheld from the client's paychecks

B. Increasing withholding allowances always increases, rather than decreases, the amount withheld from each paycheck

C. A balance due can only ever be addressed by making estimated tax payments, never through W-4 withholding changes

D. Adjusting W-4 withholding to more closely match actual expected tax liability can reduce or eliminate a future balance due and potential underpayment penalty exposure

86. A client asks a practitioner to represent them in an IRS collection matter but the practitioner has never actually prepared the client's returns. Under Circular 230, what determines whether the practitioner may represent this client before the IRS?

A. Practitioner status generally derives from the specific credential held, such as enrolled agent, CPA, or attorney status, rather than from having personally prepared the client's return

B. Only the original return preparer may ever represent a taxpayer before the IRS on any matter

C. Representation before the IRS requires no professional credential of any kind under current rules

D. A practitioner may represent a client only if that same practitioner also currently holds a valid PTIN for the current filing season regardless of credential

87. A client wants general guidance on the tax treatment difference between contributing to a 529 college savings plan versus a Coverdell Education Savings Account for a young dependent's future education expenses. What is a key distinction a practitioner should generally note?

A. Both account types are subject to identical federal contribution limits and identical contributor income restrictions

B. 529 plans generally have no federal contribution income limit, unlike Coverdell accounts' lower cap

C. Coverdell accounts have unlimited annual contribution capacity while 529 plans are capped at $2,000 per year

D. Neither account type allows any tax-free growth or tax-free qualified withdrawal treatment at all

88. A simple trust's governing instrument requires all income to be distributed currently to a single beneficiary each year, and the trust has no capital gains allocated to income for the year. How is the trust's distributable net income generally taxed under these facts?

A. The income is taxed entirely to the trust itself regardless of the required current distribution

B. The income is split evenly between the trust and the beneficiary regardless of the distribution requirement

C. The income is generally taxed to the beneficiary who received the distribution, with the trust taking a corresponding distribution deduction, rather than being taxed to the trust itself

D. The income is entirely tax-exempt for both the trust and the beneficiary under simple trust rules

89. An estate's fiduciary income tax return, Form 1041, reports income earned by the decedent's estate after death but before final distribution of assets to the heirs. What general filing threshold triggers the requirement to file this return?

A. Generally, gross income of $600 or more for the estate's tax year triggers the Form 1041 filing requirement

B. Form 1041 must be filed regardless of the estate's gross income, even if the estate earned no income at all

C. The threshold is identical to the individual standard deduction amount applicable to the decedent's prior filing status

D. Form 1041 is only required once the estate's total assets exceed the federal estate tax exemption amount

90. A taxpayer's Report of Foreign Bank and Financial Accounts (FBAR), FinCEN Form 114, is generally required when the aggregate value of the taxpayer's foreign financial accounts exceeds what threshold at any point during the calendar year?

A. $50,000 in aggregate value, matching the higher Form 8938 domestic-filed threshold for unmarried taxpayers

B. $100,000 in aggregate value regardless of the taxpayer's filing status

C. There is no dollar threshold at all; any foreign account of any value triggers the FBAR filing requirement

D. $10,000 in aggregate value across all foreign financial accounts at any time during the year

91. A nonresident alien who worked temporarily in the United States during the year must generally determine which tax return to file based on residency status tests. What is the general filing requirement for a nonresident alien with U.S.-source income?

A. The nonresident alien must always file the standard Form 1040 exactly as a U.S. citizen would

B. The nonresident alien generally files Form 1040-NR, reporting only income effectively connected with a U.S. trade or business and certain other U.S.-source income

C. Nonresident aliens are entirely exempt from any U.S. tax filing requirement regardless of U.S.-source income

D. Nonresident aliens are only required to file if their worldwide income exceeds $250,000 for the year

92. A taxpayer who is a bona fide resident of Puerto Rico for the entire tax year generally excludes Puerto Rico-source income from U.S. federal taxable income. How does this general exclusion typically affect the taxpayer's U.S. filing obligation?

A. The taxpayer is entirely exempt from any U.S. federal tax filing obligation regardless of any non-Puerto-Rico income earned

B. All income, regardless of source, must be fully reported and taxed exactly as it would be for a mainland U.S. resident

C. The taxpayer generally excludes Puerto Rico-source income under the applicable statutory exclusion, while still generally required to report and pay U.S. tax on non-Puerto-Rico-source income

D. The exclusion applies only to unearned investment income and never applies to Puerto Rico-source wage income

93. A decedent's final individual income tax return, covering the period from the beginning of the year through the date of death, is generally filed using which form and reporting which items of income?

A. A completely separate specialized decedent-only tax form distinct from the standard Form 1040 used by living taxpayers

B. Form 1041 is used for the decedent's own final personal income rather than Form 1040

C. The decedent's final Form 1040, reporting income actually or constructively received up through the date of death, using the decedent's normal filing status and accounting method

D. No final return is ever required for a decedent regardless of income received before the date of death

94. A grantor trust is structured so that the grantor retains sufficient control or economic benefit over the trust's assets under the applicable grantor trust rules. How is the trust's income generally taxed as a result of this classification?

A. The trust's income is taxed entirely at the trust's own separate, generally compressed fiduciary tax rate schedule

B. The trust's income is generally taxed directly to the grantor on the grantor's own individual income tax return, rather than being taxed to the trust or its beneficiaries

C. The trust's income is split evenly between the trust entity and the named beneficiaries regardless of the grantor's retained control

D. Grantor trust classification has no effect at all on which party bears responsibility for reporting the trust's income

95. A U.S. citizen living and working abroad qualifies for the Foreign Earned Income Exclusion under the bona fide residence test rather than the physical presence test. What is the general distinguishing feature of the bona fide residence test?

A. It requires being physically present in a foreign country for at least 330 full days within any twelve-month period

B. It applies only to taxpayers who have permanently and irrevocably renounced U.S. citizenship

C. It requires the taxpayer's employer to also be a foreign corporation with no U.S. ownership at all

D. It generally requires establishing genuine residency in a foreign country for an uninterrupted period that includes a full tax year, rather than counting specific days of physical presence

96. An estate's Form 706 federal estate tax return is generally required to be filed when the gross estate, plus certain adjusted taxable gifts, exceeds the applicable exclusion amount for the year of death. What is the general purpose of the portability election available on this return?

A. It allows a surviving spouse to use any of the deceased spouse's unused federal estate tax exclusion amount, in addition to the surviving spouse's own exclusion

B. It permanently transfers the entire estate tax exclusion to the couple's children rather than to the surviving spouse

C. It eliminates the federal estate tax filing requirement entirely for any subsequent spouse who remarries

D. It applies only to state-level estate taxes and has no effect at all on the federal estate tax exclusion

97. A taxpayer received a Schedule K-1 from a partnership reporting the taxpayer's distributive share of partnership income, deductions, and credits for the year. How does the taxpayer generally report these items on their individual Form 1040?

A. The taxpayer generally reports the distributive share items directly on the appropriate individual return schedules, regardless of whether any cash was actually distributed during the year

B. The taxpayer reports these items only if the partnership actually distributed cash matching the reported income amount

C. Partnership K-1 income is never reported on an individual taxpayer's own Form 1040 under any circumstances

D. The partnership itself pays all tax on this income directly, with no reporting required at all by the individual taxpayer

98. A taxpayer's household employee, such as a nanny, was paid $3,000 in cash wages during the year, exceeding the applicable annual threshold requiring the taxpayer to withhold and pay Social Security and Medicare taxes. Which schedule is generally used to report this obligation?

A. Schedule C, since a household employee is treated identically to the taxpayer's own self-employment business

B. Schedule E, since household employment taxes are treated as a rental or royalty-related expense

C. Schedule H, filed with the taxpayer's Form 1040, reporting household employment taxes owed for the year

D. No separate schedule is required at all; household employment taxes are simply included in Form 1040's wage line

99. A complex trust, unlike a simple trust, is permitted to accumulate income, make distributions of principal, and provide for charitable distributions. How does this classification generally affect the trust's own income tax liability?

A. A complex trust is entirely exempt from any federal income tax liability at the trust level under all circumstances

B. A complex trust may be taxed directly on any income it accumulates and does not distribute, using the trust's own separate, notably compressed tax rate schedule

C. A complex trust must always distribute 100% of its income currently, making it functionally identical to a simple trust

D. Complex trust classification eliminates the need for any Form 1041 filing at the trust level altogether

100. A U.S. citizen taxpayer holds specified foreign financial assets with an aggregate value exceeding the applicable Form 8938 reporting threshold for the taxpayer's filing status, in addition to already filing an FBAR for the same accounts. What is the general relationship between these two reporting requirements?

A. Filing the FBAR automatically satisfies the separate Form 8938 filing requirement, making a separate Form 8938 unnecessary

B. Form 8938 completely replaces the FBAR filing requirement for all U.S. taxpayers going forward

C. Only one of the two forms may ever be filed in the same tax year under current law

D. Form 8938 and the FBAR are separate, independent filing requirements with different thresholds and different filing agencies, and satisfying one does not eliminate the obligation to file the other

Answer Key and Explanations — Practice Exam 7

1. D — A foreign passport combined with a valid ITIN letter is generally adequate documentation for a taxpayer who uses an Individual Taxpayer Identification Number rather than a Social Security number, since not every taxpayer is eligible for an SSN. Refusing service or requiring an SSN application is not the correct approach here.

2. B — Since the IRS matches the name on a filed return against SSA records, the preparer should generally advise using the name currently on file with the SSA until the client formally updates their Social Security card, to avoid a name mismatch that could delay processing or cause an e-file rejection.

3. A — A stepchild meets the relationship test for qualifying child status just as a biological child would. With full-year residency and majority support provided by the couple, this stepdaughter generally qualifies as a qualifying child on the couple's joint return, assuming the age and other standard tests are also independently met and documented.

4. C — The American Opportunity Credit is limited to four total tax years per eligible student. A fifth year of coursework does not qualify for that specific credit, so the preparer should recommend correcting the prior-year error via Form 1040-X, potentially substituting the separate Lifetime Learning Credit if the student otherwise qualifies.

5. C — A preparer should reconcile the Form 1099-K's reported gross transaction total against the client's own detailed records, adjusting for refunds, chargebacks, or other discrepancies, to arrive at the taxpayer's correct net business income for Schedule C, rather than blindly reporting the unadjusted platform total or disregarding the form entirely without review.

6. B — An IRS account transcript, or the taxpayer's own IRS online account, directly shows the actual economic impact payments issued to that taxpayer, allowing the preparer to confirm whether a prior Recovery Rebate Credit was properly reconciled, rather than relying on the client's uncertain memory or unrelated financial documents that may be incomplete.

7. A — The joint return test generally disqualifies a married dependent who files jointly, but a specific exception applies when the couple files solely to claim a refund of withheld tax and neither spouse would otherwise have a tax liability filing separately. That exception applies here, so the son remains a valid dependent.

8. D — Form 2848 grants a designated representative full power of attorney authority, including the ability to represent the taxpayer, negotiate directly with the IRS, and in some circumstances sign documents on the taxpayer's behalf, unlike Form 8821, which only authorizes disclosure of tax information without granting any representation authority whatsoever to the recipient.

9. B — A sibling can potentially qualify as a qualifying relative, but must still satisfy the gross income test, requiring income under a specific annual limit regardless of the relationship. Since this sibling's $9,000 in wages exceeds that limit, the sibling does not qualify as a dependent, regardless of support the taxpayer actually provided.

10. D — Federal tax law generally requires reporting all tip income as taxable, regardless of whether the tips were reported to the employer or reflected on a Form W-2. The preparer should advise the client that unreported cash tips remain fully taxable and must be included as income on the filed return.

11. A — For federal tax purposes, a marriage is generally recognized based on the law of the jurisdiction where it was validly performed, including a foreign country, as long as the marriage would be recognized in at least one U.S. state. No separate U.S. certificate or special IRS approval is generally required.

12. C — Losing full-time student status can affect the qualifying child age test, generally reducing eligibility from under-24 to under-19 for a non-disabled dependent. The preparer should evaluate whether the dependent still independently qualifies under the applicable age limit and other tests, rather than assuming automatic continuation or automatic disqualification either way.

13. D — A mismatch between the address on a Form W-4 filed with an employer and the address on the current tax return generally has limited direct significance for return preparation, since the address shown on the filed tax return itself controls where future IRS correspondence is generally sent going forward each year.

14. B — Rental income is generally taxable and reportable regardless of whether a formal written lease exists. Bank records showing a consistent pattern of rental deposits can serve as reasonable substantiation to help identify and calculate the taxpayer's actual reportable rental income for the return, even absent formal lease documentation on file.

15. C — A parent is a unique exception to the general Head of Household rule requiring the qualifying person to live with the taxpayer. As long as the taxpayer pays more than half the cost of maintaining the parent's own separate home and the parent otherwise qualifies as a dependent, Head of Household remains available.

16. A — Representation authority granted under Form 2848 generally does not extend to receiving the client's refund directly into the representative's own account, which requires a separate, specific arrangement and is subject to additional restrictions under Circular 230, distinct from the general representation authority the form otherwise provides to a licensed practitioner.

17. A — Employer-provided adoption assistance paid under a qualifying written plan is generally excluded from the employee's taxable income up to the applicable annual exclusion limit set for adoption assistance benefits. This specific exclusion is separate from, and generally cannot be combined with, the taxpayer's own separately available Adoption Credit for the same expenses.

18. B — Failing to take a full required minimum distribution generally triggers a 25% excise tax on the shortfall amount, potentially reduced further to 10% if the shortfall is timely corrected within the applicable correction window, regardless of whether the underlying error was caused by administrator miscalculation rather than the taxpayer's own choice.

19. D — Long-term gain on collectibles, including fine art, coins, antiques, and precious metals, is subject to a special maximum federal rate of 28%, higher than the standard 0%, 15%, or 20%

preferential rate schedule that applies to most other categories of long-term capital gain property sold by an individual taxpayer during the year.

20. C — When a survivor annuity continues after the original pensioner's death, the recipient beneficiary, whether a surviving spouse, child, or other named beneficiary, generally continues recovering any remaining unrecovered investment (basis) the original pensioner had not yet fully recovered, using the same underlying basis-recovery calculation regardless of the specific beneficiary's relationship.

21. A — Employer payments toward an employee's qualified student loans, made under a qualifying educational assistance program, can be excluded from the employee's taxable income up to the combined annual $5,250 limit shared with other educational assistance benefits provided under the same program during that same calendar tax year for that employee.

22. B — Capital gains and losses are ultimately netted together regardless of their short-term or long-term character, after first netting separately within each category. Here, the $9,000 short-term loss offsets the $7,000 long-term gain, leaving a net $2,000 short-term capital loss remaining, potentially usable against ordinary income up to the annual limit.

23. D — Unlike certain other wellness-related benefits with specific IRS guidance, an on-site or off-site gym membership benefit generally lacks a specific statutory exclusion under current federal law, and its value is generally includible in the employee's taxable wages for the year, unlike a genuine on-premises athletic facility exclusively for employee use.

24. A — A bug bounty reward, like other prize, award, or reward income, is fully includible in the recipient's gross income as ordinary taxable income for the year received, regardless of whether the paying party is a private company or government agency, with no special statutory exemption applicable to this specific type of reward.

25. C — Interest credited under a fixed indexed annuity, whether from the guaranteed minimum component or the additional index-linked variable component, is treated in its entirety as ordinary taxable income when eventually distributed to the extent it exceeds the taxpayer's own after-tax investment, with no separate exclusion for either specific credited component.

26. D — When an IRA administrative or transfer fee is paid directly from the IRA's own account balance, rather than separately by the taxpayer using outside funds, it is generally not treated as a taxable distribution to the taxpayer, unlike a fee the taxpayer instead pays out-of-pocket, which was formerly a miscellaneous deduction now suspended.

27. B — The statutory exclusion that previously applied to qualified bicycle commuting reimbursements has been suspended under current federal law for most employees. As a result, the value of any employer-provided bicycle commuting reimbursement is generally includible in the employee's taxable wages for the year, unlike certain other transportation benefits that remain excludable.

28. C — The substantially equal periodic payment exception under Section 72(t) allows penalty-free early IRA distributions, calculated using one of several IRS-approved actuarial methods, as long as the payments continue for the required minimum duration, generally the later of five years or reaching age 59½, without any modification during that required period.

29. C — Unlike a Series EE or Series I bond, which generally accrues interest internally until redemption, a Series HH bond pays interest semiannually directly to the bondholder, and each such payment is fully includible as ordinary taxable interest income in the specific year it is actually received, rather than being deferred until maturity.

30. D — A qualified tuition reduction, available specifically to employees of an educational institution such as the university itself, is generally excluded from the employee's taxable income under its own specific statutory provision, separate from and in addition to the general $5,250 employer educational assistance exclusion available to employees more broadly each year.

31. B — Mandatory 20% withholding on a direct qualified plan distribution functions similarly to wage withholding: it is credited against the taxpayer's total tax liability for the year when the return is filed, potentially resulting in a refund of any excess withheld, rather than representing a separate, additional tax on top of regular liability.

32. A — Even under the active-duty military exception preserving the moving expense reimbursement exclusion, any reimbursement amount exceeding the service member's actual substantiated moving expenses is generally includible in taxable wages, similar to the accountable plan rules that require excess reimbursements above actual documented costs to be treated as taxable compensation received.

33. D — Qualified dividend treatment depends on meeting specific requirements, including a minimum holding period and payer eligibility, not simply on whether the payer is domestic or foreign with treaty benefits. Here, the treaty-eligible foreign dividend meeting the requirements receives preferential rates, while the domestic dividend failing the holding period is taxed as ordinary income.

34. B — A rollover from a SIMPLE IRA to a different type of IRA, such as a traditional IRA, within the first two years of participation is generally treated as a fully taxable distribution, subject to an enhanced 25% additional tax, rather than the standard 10% penalty, reflecting the SIMPLE IRA's own specific two-year holding requirement.

35. C — The qualified higher education expense exception removes the 10% early distribution penalty on an otherwise premature traditional IRA distribution used for tuition and other qualified costs, whether for the taxpayer or an eligible family member, though the distributed amount remains includible in the taxpayer's ordinary taxable income for the year.

36. A — A financial wellness or budgeting app subscription provided as a general employee benefit generally lacks a specific statutory exclusion, unlike the narrower category of employer-provided qualified retirement planning services. Its value is generally includible in the employee's taxable wages for the year, similar to other general wellness-type benefits lacking a specific exclusion.

37. A — When a charity keeps a donated vehicle for its own significant intervening use, rather than selling it, the taxpayer's deduction is generally based on the vehicle's fair market value rather than being limited to the charity's eventual sale proceeds, which is the more restrictive rule that applies specifically to a subsequent resale.

38. C — The Child Tax Credit age test simply requires the qualifying child to be under age 17 as of the last day of the tax year, December 31, with no proration based on the child's specific birth date during that same year. A child born mid-year fully qualifies for the entire credit for that tax year.

39. B — A solo 401(k), despite being established by a self-employed individual for their own business, is still an employer retirement plan for active participant determination purposes. Contributing to it generally causes the taxpayer to be treated as an active participant, subjecting their own separate traditional IRA deduction to the applicable phase-out range.

40. D — The Lifetime Learning Credit is broadly available for qualifying coursework at an eligible institution, without requiring the coursework be connected to the taxpayer's current job, a degree program, or any specific career path, unlike some narrower requirements that apply to other, more restrictive education-related tax benefits available under current law.

41. A — While the Energy Efficient Home Improvement Credit generally provides 30% of qualifying costs, exterior doors are subject to a specific $250 per-door cap, with a separate $500 aggregate cap across all doors. Since 30% of $2,500 equals $750, which exceeds the $250 per-door cap, the credit for this single door is limited to $250.

42. D — When neither spouse is an active participant in any employer retirement plan for the year, the traditional IRA contribution deduction is generally not subject to any modified AGI phase-out at all, regardless of how high the couple's combined income level might otherwise be, unlike when one or both spouses actively participate.

43. C — A specific rule protects a taxpayer whose Marketplace application in good faith reasonably estimated household income above the federal poverty line at the time of enrollment, even if actual year-end income came in below that threshold, generally allowing the Premium Tax Credit to remain available rather than being entirely disallowed.

44. B — When an excess IRA contribution is timely corrected along with its attributable earnings, those earnings are generally includible in the taxpayer's taxable income for the year the original excess contribution was actually made, rather than the year the corrective withdrawal itself occurs, which can require amending a prior-year return if already filed.

45. A — The Child and Dependent Care Credit generally disqualifies payments made to the taxpayer's own child who is under age 19 at year-end, or to someone claimed as the taxpayer's dependent, but payment to another relative, including an adult child over 19 who is not a dependent, can generally still qualify for the credit.

46. C — At the very bottom edge of the applicable modified AGI phase-out range, the traditional IRA deduction generally remains fully available, with the proportional reduction only beginning to actually apply as the taxpayer's income rises above that specific starting point and moves further into the phase-out range toward the upper limit.

47. B — For IRA contribution purposes, a self-employed taxpayer's earned income is generally calculated as net self-employment earnings reduced by the deduction for one-half of self-employment tax, meaning the $88,290 figure, not the higher gross $95,000 figure, represents the taxpayer's usable compensation for calculating the maximum allowable annual IRA contribution for the year.

48. D — The Saver's Credit calculation is capped at a maximum eligible contribution amount, generally $2,000 per individual, regardless of the taxpayer's actual larger contribution. Amounts contributed above that specific $2,000 cap simply do not factor into or increase the resulting credit calculation for the year, though the contribution itself may still count toward IRA limits.

49. A — A direct rollover from a traditional 401(k) into a Roth IRA is a taxable Roth conversion: the converted pretax amount is generally includible in the taxpayer's taxable income for the year of conversion, just as with any other Roth conversion, even though the transfer itself is completed directly between trustees rather than received by the taxpayer.

50. C — IRA contributions generally require the taxpayer to have compensation, meaning earned income such as wages or net self-employment earnings, for the year. Investment income, such as interest and dividends, and rental income generally do not count as compensation for this specific requirement, regardless of how substantial that other income might otherwise be.

51. D — When a home equity loan or cash-neutral refinance is used entirely to pay off existing acquisition debt with no additional cash taken out, the resulting interest generally remains fully deductible as acquisition debt interest, since the loan's proceeds simply replaced the original qualifying acquisition debt rather than being used for an unrelated purpose.

52. B — The Child and Dependent Care Credit equals the applicable percentage rate, here 30% based on the taxpayer's AGI, multiplied by the lesser of actual qualifying expenses or the applicable expense cap. Since the $2,500 in actual expenses falls under the $3,000 one-child cap, 30% of $2,500 yields a $750 credit for the year.

53. C — Active participant status for traditional IRA deduction purposes is generally determined on an all-or-nothing basis for the entire tax year: even active participation for only a portion of the year, before a plan terminates, generally still triggers active participant status for that full year, subjecting the deduction to the applicable phase-out range.

54. D — The American Opportunity Credit formula provides 100% of the first $2,000 in qualified expenses plus 25% of the next $2,000, for a maximum credit of $2,500. Applying this formula to $4,500 in qualifying expenses yields $2,000 plus $500 (25% of the next $2,000), for a total $2,500 credit, with the remaining $500 in expenses generating no further credit.

55. B — A properly completed rollover contribution, moving existing retirement funds from one account to another within the required timeframe, does not represent genuinely new money being added to the retirement system, unlike a regular annual contribution, which is why rollover contributions generally do not count against the taxpayer's own separate annual contribution limit.

56. A — Unreimbursed medical expenses are deductible only to the extent they exceed 7.5% of AGI. Here, 7.5% of $60,000 is $4,500, and total qualifying expenses of $10,500 minus that $4,500 floor leaves $6,000 as the deductible amount properly reported on Schedule A for the year, assuming the taxpayer itemizes rather than takes the standard deduction.

57. C — The U.S. federal income tax system is progressive: each marginal rate applies only to the specific slice of income within that bracket, not to all income at the top rate reached. The couple's total tax liability is the sum of tax owed across each bracket their $95,000 of taxable income passes through.

58. A — Qualified dividends receive preferential long-term capital gains tax treatment rather than being taxed as ordinary income. For a taxpayer in the 22% ordinary bracket, qualified dividends are generally taxed at the 15% preferential rate rather than the taxpayer's higher ordinary marginal rate, reducing the overall tax owed on that income.

59. B — The AMT exists to ensure taxpayers with substantial tax preference items and adjustments still pay a baseline minimum tax. The taxpayer computes tentative minimum tax under the separate AMT rules and pays the regular tax plus any excess of tentative minimum tax over the regular tax amount owed for that year.

60. D — Unrecaptured Section 1250 gain, representing the depreciation previously claimed on real property, is taxed at a maximum federal rate of 25%, which is higher than the standard preferential long-term capital gains rates but lower than ordinary income rates, reflecting its own distinct statutory treatment under current federal tax law provisions.

61. A — The Net Investment Income Tax applies a 3.8% rate to the lesser of net investment income or the amount by which modified AGI exceeds the applicable threshold. Since the $20,000 MAGI excess is smaller than the $30,000 of net investment income, the tax applies to the smaller $20,000 excess figure instead.

62. C — Below the applicable taxable income threshold, the wage limitation and specified service trade or business restrictions generally do not apply, and the QBI deduction is generally the lesser of 20% of qualified business income or 20% of taxable income reduced by net capital gain for that particular tax year in question.

63. D — Self-Employment Tax is calculated by first multiplying net self-employment earnings by 92.35% to approximate the employer-equivalent wage base, then applying the combined 15.3% rate (12.4% Social Security up to the wage base, plus 2.9% Medicare) to that adjusted figure to determine the taxpayer's total self-employment tax owed for the year.

64. B — When a taxpayer's withholding and timely estimated payments fall short of the total tax liability, an estimated tax underpayment penalty may apply to the shortfall unless the taxpayer meets a safe harbor exception, such as paying at least 90% of the current year's liability or 100/110% of the prior year's liability.

65. C — Capital losses exceeding capital gains are deductible against ordinary income up to an annual $3,000 limit ($1,500 if married filing separately), with any excess loss beyond that annual limit carried forward to future tax years until fully used against future capital gains or the same annual limit in a later year.

66. D — When a taxpayer's total tax payments for the year, including withholding and estimated payments, exceed the total tax liability shown on the return, the excess amount is generally refundable to the taxpayer or may instead be applied toward the following year's estimated tax liability rather than refunded immediately in cash.

67. B — The Kiddie Tax rules generally tax a dependent child's unearned income above the applicable threshold at the parent's marginal tax rate, rather than the child's own typically lower rate, preventing income-shifting strategies that would otherwise reduce a family's overall combined tax liability by exploiting the child's lower individual tax bracket.

68. A — When net long-term capital gain exceeds net short-term capital loss after separate internal netting within each respective category, the short-term loss is applied against the long-term gain, and the resulting net gain retains its long-term character, remaining eligible for preferential long-term capital gains tax rates on the entire net amount.

69. C — A taxpayer generally benefits from claiming whichever amount is larger between the standard deduction and total itemized deductions, since a larger deduction produces lower taxable income overall. Here, the $14,600 standard deduction exceeds the $9,000 in itemized deductions, so the standard deduction should generally be used when preparing this return.

70. B — Exercising incentive stock options generally does not trigger regular income tax on the bargain element at exercise, but that same bargain element is added back as a positive adjustment for AMT purposes, which can trigger AMT liability even though no regular tax is currently due from the exercise itself this year.

71. D — A self-employed taxpayer may deduct one-half of the self-employment tax paid for the year as an above-the-line adjustment to gross income, reflecting the employer-equivalent portion of the combined Social Security and Medicare tax, while the regular income tax itself remains non-deductible against income in any future tax year at all.

72. A — Nonrefundable credits reduce tax liability but generally cannot reduce it below zero, and any unused nonrefundable credit amount is typically not refunded to the taxpayer in cash, though certain credits, such as the general business credit, may allow unused amounts to be carried forward to future tax years for later use.

73. B — The 10% additional tax on early retirement distributions that do not qualify for an exception is calculated and reported as an addition to the taxpayer's total tax liability, generally on Schedule 2, added on top of the regular income tax rather than reducing it or replacing any other tax calculation.

74. D — Tax-exempt municipal bond interest, while excluded from taxable income itself, is still reported on the return because it factors into several other calculations, such as determining what portion of Social Security benefits is taxable and certain modified AGI-based phase-out thresholds used elsewhere for other credits and deductions on the return.

75. A — Circular 230 generally requires a practitioner to advise a client of any opportunity to avoid a penalty through adequate disclosure and the specific requirements for that disclosure, when recommending a tax position that does not meet the substantial authority standard but does have at least a reasonable basis for the position.

76. C — Circular 230 requires a practitioner who becomes aware of a client's error or omission on a previously filed return to promptly advise the client of the error and the consequences under the Code and regulations, but the practitioner may not disclose the error to the IRS without the client's consent.

77. B — A taxpayer generally avoids an underpayment penalty by paying, through timely withholding and estimated payments, the lesser of 90% of the current year's tax or 100% of the prior year's tax liability (110% if prior-year AGI exceeded $150,000), providing a safe harbor even if current-year income increases significantly over the prior year.

78. C — The key distinction a practitioner should explain is the timing of taxation: traditional 401(k) deferrals reduce current taxable wages, with tax paid later upon eventual withdrawal, while Roth 401(k) contributions are made with after-tax dollars now, but qualified withdrawals taken in retirement are generally entirely tax-free to the account owner.

79. A — A practitioner should explain that HSA funds remain the owner's property and generally roll over indefinitely year to year with no forfeiture, while FSA funds are typically subject to a use-it-or-lose-it rule, though some plans allow a limited carryover amount or a short grace period before unused funds are forfeited.

80. D — A practitioner should generally advise that an early traditional IRA withdrawal taken before age 59½ is subject to both ordinary income tax on the distributed amount and an additional 10% early distribution penalty unless a specific statutory exception applies, making it typically a costly way to address short-term consumer debt.

81. A — Bunching deductible expenses, such as charitable contributions, into a single tax year rather than spreading them evenly can push total itemized deductions above the standard deduction threshold in that bunched year, while the taxpayer simply claims the standard deduction in the other years, potentially increasing total deductions claimed over time.

82. B — A practitioner should explain that a Roth conversion generally requires including the converted amount in taxable income in the year of conversion, but qualified future withdrawals from the Roth IRA are generally tax-free, which can be advantageous for a client expecting to be in a higher tax bracket in later years.

83. C — A practitioner should explain that an S corporation shareholder-employee generally pays payroll taxes only on a reasonable salary amount determined for the role, while additional profit distributed as a distribution is generally not subject to self-employment tax, unlike a sole proprietor, whose entire net profit is generally subject to self-employment tax each year.

84. D — Circular 230 requires that a practitioner may not sign a return, or advise a position on a return, that the practitioner knows or reasonably should know lacks a reasonable basis. A practitioner should decline to prepare or sign a return containing such an unsupportable position, regardless of the client's request.

85. D — A practitioner should explain that adjusting Form W-4 withholding to more closely align with a taxpayer's actual expected annual tax liability is a reasonable strategy to reduce or eliminate a future balance due, and can also help the taxpayer avoid a potential underpayment penalty in future filing years as well.

86. A — Under Circular 230, the authority to represent a taxpayer before the IRS generally derives from the practitioner's own underlying credential, such as enrolled agent, CPA, or attorney status, together with a properly executed power of attorney, rather than from having personally prepared that particular client's tax return in a prior year.

87. B — A practitioner should note that 529 college savings plans generally have no federal contribution income limitation and allow much higher effective contribution levels overall, while Coverdell Education Savings Accounts are subject to a $2,000 annual contribution limit per beneficiary and a contributor modified AGI phase-out range that can eliminate eligibility entirely.

88. C — A simple trust, required to distribute all income currently, generally passes that income through to the beneficiary for tax purposes. The beneficiary reports and pays tax on the distributed income, while the trust claims a corresponding distribution deduction, avoiding taxation of that same income a second time at the trust level.

89. A — An estate is generally required to file Form 1041 if its gross income for the tax year is $600 or more, regardless of whether any tax is ultimately due, distinguishing this fiduciary filing threshold from the different, generally higher filing thresholds that apply to individual taxpayers filing their own returns.

90. D — An FBAR filing is generally required when the aggregate value of a U.S. person's foreign financial accounts exceeds $10,000 at any point during the calendar year, a distinctly lower threshold than the higher, filing-status-dependent thresholds that apply separately under the related Form 8938 foreign financial asset reporting requirement instead of the FBAR.

91. B — A nonresident alien with U.S.-source income generally files Form 1040-NR rather than the standard Form 1040, reporting income effectively connected with a U.S. trade or business along with certain other categories of U.S.-source income, subject to the specific statutory rules that generally apply to nonresident alien taxation under the Code.

92. C — A bona fide resident of Puerto Rico for the entire tax year generally excludes Puerto Rico-source income from U.S. federal taxable income under the applicable statutory exclusion, while remaining generally subject to U.S. federal tax on income from sources outside Puerto Rico, such as mainland U.S.-source wages or investment income.

93. C — A decedent's final income tax return is generally filed on the standard Form 1040, covering income actually or constructively received from the start of the year through the date of death, using the decedent's regular filing status and accounting method, distinct from the estate's own separate Form 1041 filing for income received after death.

94. B — Under the grantor trust rules, when a grantor retains sufficient control or economic benefit over trust assets, the trust is treated as a disregarded entity for income tax purposes, and the trust's income, deductions, and credits are generally reported directly on the grantor's own individual income tax return each year.

95. D — The bona fide residence test generally requires a taxpayer to establish genuine, uninterrupted residency in a foreign country that includes an entire tax year, focusing on the nature and permanence of the taxpayer's stay abroad, distinct from the physical presence test's specific 330-full-day counting requirement within any twelve-month period selected.

96. A — The portability election, made on a timely filed Form 706, allows a surviving spouse to use any unused portion of a deceased spouse's federal estate tax exclusion amount, in addition to the surviving spouse's own exclusion, generally requiring a return to be filed even if the estate itself owes no estate tax.

97. A — A partnership is generally treated as a pass-through entity, and each partner reports their distributive share of partnership income, deductions, and credits directly on their individual Form 1040, based on the Schedule K-1 received, regardless of whether the partnership actually made a cash distribution matching that amount during the tax year.

98. C — When a taxpayer pays a household employee cash wages exceeding the applicable annual threshold, the taxpayer generally reports and pays the associated Social Security, Medicare, and any applicable federal unemployment tax obligations using Schedule H, filed together with the taxpayer's own individual Form 1040 for that same particular tax year.

99. B — Unlike a simple trust, a complex trust may accumulate income rather than distributing it all currently, and any income the trust accumulates and does not distribute is generally taxed directly to the trust itself, using the trust's own separate income tax rate schedule, which reaches the top marginal rate at a much lower income level than individual brackets.

100. D — Form 8938 and the FBAR (FinCEN Form 114) are separate, independent reporting requirements administered by two different federal agencies, with different applicable dollar thresholds based on filing status and residency. A taxpayer meeting both thresholds must generally file both forms; filing one does not satisfy the other's separate filing obligation.