

10 Hour Federal Tax Law Practice Exam (Sample)

Study Guide



Everything you need from our exam experts!

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Questions

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- 1. In 2023, when is a taxpayer not required to file Schedule H?**
 - A. Paid \$2,000 to a family friend for yard work**
 - B. Paid \$2,000 to his or her father to help install a new fence**
 - C. Paid \$2,000 to a neighbor for cleaning**
 - D. Paid \$2,000 to his or her sibling for babysitting**
- 2. What is the purpose of making quarterly estimated tax payments?**
 - A. To manage cash flow effectively**
 - B. To avoid penalties for underpayment**
 - C. To increase tax refund claims**
 - D. To boost government revenue**
- 3. What is the significance of Form 8862?**
 - A. It is used to claim the Child Tax Credit**
 - B. It is used to claim the Earned Income Tax Credit after previous disallowance**
 - C. It is used to report self-employment income**
 - D. It is used to claim the American Opportunity Credit**
- 4. What is the purpose of Form 1099?**
 - A. To report wages and taxes withheld**
 - B. To report various types of income other than wages**
 - C. To claim a refund on overpaid taxes**
 - D. To apply for tax credits**
- 5. What does the Internal Revenue Code (IRC) regulate?**
 - A. Postal regulations within the U.S.**
 - B. State laws regarding taxation**
 - C. Federal tax law and income tax policy**
 - D. International trade and tariffs**

- 6. When should taxpayers begin to plan for their estimated tax payments?**
- A. Only the month before payments are due**
 - B. At the start of the taxable year**
 - C. After filing their previous year's tax return**
 - D. Once they start a new job**
- 7. Income that is earned without the direct involvement of the recipient is known as?**
- A. Active income**
 - B. Earned income**
 - C. Portfolio income**
 - D. Passive income**
- 8. What is the tax treatment for individual gifts?**
- A. Gifts are completely tax-free for both the giver and receiver**
 - B. Gifts above the annual exclusion amount may require filing a tax return**
 - C. All gifts must be reported as income by the receiver**
 - D. Gifts are only taxable if given overseas**
- 9. Which component is essential for determining an individual's AGI?**
- A. Total business deductions**
 - B. Specific adjustments and deductions**
 - C. Total tax credits**
 - D. Exemptions claimed**
- 10. Which of the following groups is NOT required to pay estimated taxes?**
- A. Self-employed individuals**
 - B. Taxpayers with little to no income**
 - C. Part-time freelancers**
 - D. Investors with capital gains**

Answers

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

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Explanations

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1. In 2023, when is a taxpayer not required to file Schedule H?

- A. Paid \$2,000 to a family friend for yard work**
- B. Paid \$2,000 to his or her father to help install a new fence**
- C. Paid \$2,000 to a neighbor for cleaning**
- D. Paid \$2,000 to his or her sibling for babysitting**

To determine when a taxpayer is not required to file Schedule H, it's important to understand the purpose of Schedule H, which is used to report household employment taxes. Taxpayers typically must file this form if they pay household employees above a certain threshold or meet other specific criteria. In this scenario, option B is the correct choice because when a taxpayer pays a family member, such as a father, for work like installing a fence, that payment does not constitute household employment for the purposes of Schedule H, provided the payment is made in a casual or informal context. The IRS does not require filing for casual labor performed by family members, as these payments often fall outside the scope of formal employment standards. Conversely, paying a neighbor, a family friend, or a sibling for services such as yard work, cleaning, or babysitting often implies a more formal employment relationship. These payments can trigger the requirement to file Schedule H, especially if they exceed the stipulated threshold for reporting household employment taxes. Therefore, option B stands out as the situation where the need to file does not arise, making it an exception in this context.

2. What is the purpose of making quarterly estimated tax payments?

- A. To manage cash flow effectively**
- B. To avoid penalties for underpayment**
- C. To increase tax refund claims**
- D. To boost government revenue**

Making quarterly estimated tax payments is primarily intended to avoid penalties for underpayment. The U.S. tax system operates on a "pay-as-you-go" basis, which means taxpayers are required to pay their taxes as they earn or receive income throughout the year. When individuals or businesses do not pay enough tax through withholding or estimated payments, they may incur a penalty for underpayment. These penalties can accumulate over time and add to the overall tax liability, leading to larger payments owed at the end of the tax year. By making quarterly estimated payments, taxpayers ensure they are meeting their tax obligations regularly and reduce the risk of facing penalties when they file their annual return. This system helps the IRS collect revenue more effectively and ensures that taxpayers contribute to funding government services continuously rather than in one lump sum at tax time. Thus, making timely estimated payments is a crucial aspect of compliance with tax laws and financial planning.

3. What is the significance of Form 8862?

- A. It is used to claim the Child Tax Credit
- B. It is used to claim the Earned Income Tax Credit after previous disallowance**
- C. It is used to report self-employment income
- D. It is used to claim the American Opportunity Credit

Form 8862, "Information to Claim Earned Income Credit After Disallowance," is specifically designed for individuals who have previously had their eligibility for the Earned Income Tax Credit (EITC) denied or disallowed. When a taxpayer's claim for the EITC is disallowed in one year, they must provide additional information in the following years if they wish to claim the credit again. This form allows the taxpayer to demonstrate that they now qualify for the credit. The importance of this form lies in ensuring that the taxpayer complies with IRS regulations regarding EITC eligibility and helps to prevent fraudulent claims. By completing Form 8862, the taxpayer affirms their eligibility for the EITC after a prior disallowance, thus helping the IRS to track and assess claims more effectively. Other options do not align with the purpose of Form 8862. For instance, it is not related to the Child Tax Credit, the reporting of self-employment income, or claiming the American Opportunity Credit, which serve different purposes within tax reporting and credits.

4. What is the purpose of Form 1099?

- A. To report wages and taxes withheld
- B. To report various types of income other than wages**
- C. To claim a refund on overpaid taxes
- D. To apply for tax credits

Form 1099 is primarily used to report various types of income that a taxpayer receives throughout the year that are not classified as salary or wages. This form is especially important for freelancers, independent contractors, and others who might be compensated for services without having taxes withheld, such as in the case of self-employment income. The information provided on Form 1099 helps ensure that taxpayers accurately report their taxable income to the IRS, as the agency also receives copies of these forms to verify income reported by taxpayers against what has been submitted by payers. This systematic reporting is essential for maintaining compliance with tax laws and ensuring that all income is taxed appropriately. In contrast, other options relate to different aspects of tax reporting or tax benefits that are not the primary function of Form 1099. For example, reporting wages and taxes withheld pertains to Form W-2, while claiming a refund on overpaid taxes or applying for tax credits involves different types of forms and processes, such as Form 1040 or specific credit application forms.

5. What does the Internal Revenue Code (IRC) regulate?

- A. Postal regulations within the U.S.
- B. State laws regarding taxation
- C. Federal tax law and income tax policy**
- D. International trade and tariffs

The Internal Revenue Code (IRC) is the comprehensive federal tax law in the United States. It provides the framework for federal taxation, detailing how taxes are to be assessed, collected, and enforced at the federal level. This includes various forms of taxation such as income tax, corporate tax, estate tax, gift tax, and excise taxes. The IRC also establishes the policies and procedures that govern the administration of these taxes, making it an essential part of federal tax law and income tax policy. Its primary purpose is to ensure compliance with federal tax obligations and to provide guidelines for both taxpayers and the Internal Revenue Service (IRS) in their roles within the tax system. The other options refer to areas that fall outside the jurisdiction of the IRC. Postal regulations pertain to the postal service and its operations, state laws are concerned with taxation at the state level and are governed by state legislatures, and international trade is generally governed by different statutes and agreements, not specifically covered by the IRC. Thus, the focus of the IRC is clearly on federal tax law and income tax policy, which underlies why this answer is correct.

6. When should taxpayers begin to plan for their estimated tax payments?

- A. Only the month before payments are due
- B. At the start of the taxable year**
- C. After filing their previous year's tax return
- D. Once they start a new job

Planning for estimated tax payments should ideally begin at the start of the taxable year. This approach allows individuals to comprehensively assess their expected income, potential deductions, and credits throughout the year, enabling them to estimate their tax liability more accurately. By initiating this planning process at the beginning of the year, taxpayers can make adjustments to their withholding or estimated payments as necessary, ensuring they meet their tax obligations without incurring underpayment penalties. This proactive strategy can help in budgeting for taxes as part of overall financial planning, allowing taxpayers to align their spending and saving practices accordingly. In contrast, waiting until just the month before payments are due can lead to rushed decisions and potential miscalculations, which might result in penalties for underpayment. Relying solely on the previous year's tax return to determine estimated payments might not accurately reflect the current year's income, especially if there have been significant changes in a taxpayer's financial situation. Starting to plan only when beginning a new job overlooks the need for consistent and ongoing analysis of income sources and tax liabilities over the entire year. Thus, initiating the planning process at the start of the taxable year is the most effective strategy for managing estimated tax payments.

7. Income that is earned without the direct involvement of the recipient is known as?

- A. Active income**
- B. Earned income**
- C. Portfolio income**
- D. Passive income**

Income that is earned without the direct involvement of the recipient is classified as passive income. This type of income typically arises from investments or business ventures in which an individual does not actively participate. Examples include rental income from properties, earnings from limited partnerships, or dividends from stocks where the investor does not engage in the management of the underlying assets. Passive income contrasts sharply with active income, which requires direct involvement and effort, such as wages from a job. It's also different from earned income, which encompasses pay for work performed, and portfolio income, which includes earnings from market investments in stocks, bonds, and mutual funds that may require some level of management but still do not involve active participation in day-to-day operations. Understanding these distinctions is critical when determining tax implications and eligibility for various deductions or credits, as different types of income can be treated differently under tax law.

8. What is the tax treatment for individual gifts?

- A. Gifts are completely tax-free for both the giver and receiver**
- B. Gifts above the annual exclusion amount may require filing a tax return**
- C. All gifts must be reported as income by the receiver**
- D. Gifts are only taxable if given overseas**

The correct answer highlights that gifts above the annual exclusion amount may require the giver to file a tax return. In the context of U.S. tax law, the annual exclusion is the amount that one individual can give to another individual without incurring gift tax or having to report the gift to the IRS. For the tax year 2023, this amount is \$17,000 per recipient. If a gift exceeds this amount, the giver must file a gift tax return (Form 709) to report the excess amount, though this does not necessarily mean that tax will be owed. The lifetime exemption, which allows individuals to transfer a larger amount over their lifetime without incurring gift taxes, still applies. This understanding emphasizes the key aspect of the gift tax structure in the U.S., where the responsibility of reporting falls on the donor once the established thresholds are surpassed. Thus, recognizing the requirement to file a return for gifts over the exclusion amount is crucial for compliance with tax laws. Other options do not capture the nuances of gift taxation accurately. While gifts are generally not subject to income tax for the receiver, saying they are "completely tax-free" oversimplifies the matter. Additionally, not all gifts need to be reported as income by the recipient,

9. Which component is essential for determining an individual's AGI?

A. Total business deductions

B. Specific adjustments and deductions

C. Total tax credits

D. Exemptions claimed

To determine an individual's Adjusted Gross Income (AGI), specific adjustments and deductions are essential components. AGI is calculated by taking the individual's total income and subtracting certain specified deductions, which include contributions to retirement accounts, student loan interest, and certain business expenses for self-employed individuals. This calculation is foundational because AGI serves as a starting point for many other tax calculations, including eligibility for various credits and deductions that may further reduce tax liability. Other elements like total business deductions contribute to the final income but don't specifically define AGI. Tax credits and exemptions claimed are important in the overall tax picture but occur after AGI has been determined and thus do not affect its computation directly. Therefore, specific adjustments and deductions are critical in accurately calculating AGI.

10. Which of the following groups is NOT required to pay estimated taxes?

A. Self-employed individuals

B. Taxpayers with little to no income

C. Part-time freelancers

D. Investors with capital gains

Taxpayers with little to no income are generally not required to pay estimated taxes because they may not have a tax liability that exceeds the threshold that mandates such payments. The IRS typically requires estimated tax payments when a taxpayer expects to owe a certain amount of taxes for the year, generally \$1,000 or more after subtracting withholding and refundable credits. For those with very low income or no income, it's likely that their tax liability will be negligible or nonexistent, thus alleviating their obligation to make estimated tax payments. In contrast, self-employed individuals, part-time freelancers, and investors with capital gains may have income streams that require them to make estimated tax payments throughout the year since they might anticipate owing taxes based on their earnings which are not subject to withholding.