10 Hour Federal Tax Law Practice Exam (Sample)

Study Guide

BY EXAMZIFY

Everything you need from our exam experts!

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Questions

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1. **Which of the following is not an advantage of filing a joint income tax return?**
   - A. Higher joint income tax brackets
   - B. Potential eligibility for tax credits
   - C. Double the amount of the personal exemption deduction
   - D. Combined income may lower tax liabilities

2. **If a taxpayer receives virtual currency as payment for services, what is it not subject to?**
   - A. Value-added Tax
   - B. Income Tax
   - C. Self-employment Tax
   - D. Capital Gains Tax

3. **Why might a taxpayer choose to use the IRS Form 1040-ES?**
   - A. To file their annual tax return
   - B. To calculate and pay estimated tax payments
   - C. To request a tax refund
   - D. To apply for an extension

4. **What defines "passive income"?**
   - A. Income earned from investments with active participation
   - B. Income earned from business activities with no active participation
   - C. Income derived solely from employment wages
   - D. Income earned from financial instruments with active management

5. **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

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6. **What form is commonly used by individuals to file their annual income tax return?**
   A. **Form 1040**
   B. **Form 1099**
   C. **Form W-2**
   D. **Form 4506**

7. **How can taxpayers determine their estimated tax payments?**
   A. **Based on the previous year's actual tax liability**
   B. **By consulting a tax advisor only**
   C. **By using standard deductions only**
   D. **Through the IRS website exclusively**

8. **In terms of tax treatment, how are alimony payments classified for agreements finalized after 2018?**
   A. **Tax-deductible for the payer and taxable for the recipient**
   B. **Non-deductible for the payer and non-taxable for the recipient**
   C. **Taxable for the payer and tax-deductible for the recipient**
   D. **Fully deductible for both parties**

9. **Under which condition will the IRS generally not take enforced collection actions?**
   A. **The taxpayer is in bankruptcy**
   B. **The taxpayer is actively communicating about their inability to pay**
   C. **All of the above**
   D. **The taxpayer has recently lost their job**

10. **Which itemized deduction might exceed the standard deduction?**
   A. **Mortgage interest payments**
   B. **Child tax credits**
   C. **Standard business expenses**
   D. **Miscellaneous deductions**

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Answers

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

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Explanations

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1. **Which of the following is not an advantage of filing a joint income tax return?**

   A. Higher joint income tax brackets

   B. Potential eligibility for tax credits

   C. Double the amount of the personal exemption deduction

   D. Combined income may lower tax liabilities

When considering the advantages of filing a joint income tax return, it's important to understand the implications of each option presented. Filing jointly often comes with various benefits tailored to couples, particularly regarding tax credits and deductions. The option stating "Double the amount of the personal exemption deduction" is not applicable because the personal exemption for tax purposes has been suspended under the Tax Cuts and Jobs Act for tax years 2018 through 2025. Therefore, couples filing jointly do not receive a doubled personal exemption deduction as they would have prior to this legislation. This makes it not an advantage in the current tax context. On the other hand, the other options illustrate actual advantages of filing jointly. Higher joint income tax brackets can sometimes lead couples to face less overall tax liability compared to filing separately, particularly if one partner earns significantly less. Additionally, many tax credits, such as the Earned Income Tax Credit or American Opportunity Tax Credit, may be more accessible or have higher limits for those filing jointly. Lastly, the combined income of both spouses could indeed lower tax liabilities through more favorable tax brackets and deductions applicable to joint filers, which can result in a lower overall tax rate for the couple. In summary, option C stands out as not being relevant under current law, while

2. **If a taxpayer receives virtual currency as payment for services, what is it not subject to?**

   A. Value-added Tax

   B. Income Tax

   C. Self-employment Tax

   D. Capital Gains Tax

Receiving virtual currency as payment for services falls under the category of taxable income, meaning it is subject to income tax and self-employment tax when received for services rendered. The IRS treats virtual currency as property, so any gain or loss realized from selling or exchanging it could lead to capital gains tax obligations. Value-added tax (VAT), on the other hand, is a type of indirect tax that is typically applied to the value added to goods and services at each stage of production or distribution, rather than a direct tax imposed on income or profit. Since the U.S. does not have a federal VAT system in place, and because the nature of virtual currency as payment for services is directly connected to income from those services, the correct recognition is that it is not subject to value-added tax. Thus, the context of virtual currency transactions protects taxpayers from VAT implications in the U.S. tax system, making that answer accurate.

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3. Why might a taxpayer choose to use the IRS Form 1040-ES?

A. To file their annual tax return

B. To calculate and pay estimated tax payments

C. To request a tax refund

D. To apply for an extension

A taxpayer may choose to use IRS Form 1040-ES specifically to calculate and pay estimated tax payments. This form is essential for individuals who expect to owe tax of $1,000 or more when their return is filed and who do not have enough tax withheld from their income. By using Form 1040-ES, taxpayers can determine their estimated tax liability based on their expected income, deductions, and credits for the year. This enables them to make quarterly payments throughout the year, ensuring that they meet their tax obligations and avoid potential penalties for underpayment. The other options relate to different tax processes. Filing an annual tax return is done with Form 1040, not the 1040-ES. Requesting a tax refund would typically occur after the annual return is filed and is unrelated to estimated payments. Lastly, applying for an extension involves different forms, such as Form 4868, rather than the 1040-ES, which focuses solely on estimated tax payments.

4. What defines "passive income"?

A. Income earned from investments with active participation

B. Income earned from business activities with no active participation

C. Income derived solely from employment wages

D. Income earned from financial instruments with active management

The definition of "passive income" is primarily characterized by income generated from activities in which the individual does not materially participate. This concept is particularly relevant in tax law, where different types of income are treated differently for tax purposes. Passive income typically includes earnings from rental properties, limited partnerships, and other business investments where the owner is not involved in the day-to-day operations. Therefore, the choice identifying passive income as "income earned from business activities with no active participation" accurately encapsulates this definition. In contrast, income from investments with active participation, employment wages, or financial instruments managed actively does not fall under the passive income classification. These forms of income involve some level of direct involvement or management from the earner, which differentiates them from passive income streams.

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5. 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.

6. What form is commonly used by individuals to file their annual income tax return?

A. Form 1040

B. Form 1099

C. Form W-2

D. Form 4506

Individuals commonly use Form 1040 to file their annual income tax return because it is the standard form designed by the Internal Revenue Service (IRS) for reporting a variety of types of income, including wages, dividends, capital gains, and other sources. Form 1040 allows taxpayers to detail their income, claim deductions and credits, and determine their tax liability for the year. This form is comprehensive and includes several schedules that individuals can attach depending on their specific tax situations, such as income from self-employment, itemized deductions, or certain adjustments to income. Its widespread use makes it essential for taxpayers as it accommodates various tax situations and allows for accurate reporting of their financial circumstances to the IRS. Other options serve different purposes: Form 1099 is used to report various types of income received other than wages, salary, or tips; Form W-2 is a wage and tax statement provided by an employer to employees detailing the amount earned and taxes withheld; and Form 4506 is used to request a copy of a previously filed tax return. Thus, while all these forms are important in the tax process, Form 1040 specifically addresses the needs of individuals filing their annual income tax return.

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7. How can taxpayers determine their estimated tax payments?

A. <u>**Based on the previous year's actual tax liability**</u>

B. By consulting a tax advisor only

C. By using standard deductions only

D. Through the IRS website exclusively

Taxpayers can determine their estimated tax payments primarily based on the previous year's actual tax liability. This method is generally used because it provides a practical and straightforward approach for estimating current year tax obligations. The IRS allows taxpayers to use their previous year’s tax liability as a guide, which can help ensure that they are making payments that approximate their actual tax liability for the current year. This is particularly useful for those whose income and deductions are relatively stable year over year. While consulting a tax advisor can provide personalized guidance and assistance, it is not the only method available for determining estimated payments. Using standard deductions alone does not take into account the full picture of an individual's tax situation, such as additional income or credits that might affect the total tax owed. Furthermore, relying exclusively on the IRS website might limit a taxpayer’s understanding, as they should also consider their individual circumstances and past tax performance, in conjunction with any resources available online. Thus, basing estimated payments on last year’s tax liability is a widely recognized and effective strategy.

8. In terms of tax treatment, how are alimony payments classified for agreements finalized after 2018?

A. Tax-deductible for the payer and taxable for the recipient

B. <u>**Non-deductible for the payer and non-taxable for the recipient**</u>

C. Taxable for the payer and tax-deductible for the recipient

D. Fully deductible for both parties

For agreements finalized after 2018, alimony payments are classified as non-deductible for the payer and non-taxable for the recipient. This change is a result of the Tax Cuts and Jobs Act (TCJA) which revised the tax treatment of alimony. Prior to this legislation, alimony payments were typically deductible by the payer and taxable to the recipient, which provided a tax advantage to the payer. Under the new rule, alimony does not generate a tax deduction for the payer, meaning that individuals who make these payments cannot reduce their taxable income by the amount of alimony paid. Simultaneously, the recipient of the alimony payments does not have to report this income, as they aren't taxed on it. This dual change means that neither party benefits from tax deductions or tax obligations related to alimony under agreements made after 2018, which simplifies tax reporting but may also affect negotiations in divorce agreements. Understanding this change is crucial for clients involved in divorce proceedings or in the planning stages, as it impacts financial strategies and expected tax liabilities significantly.

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9. Under which condition will the IRS generally not take enforced collection actions?

A. The taxpayer is in bankruptcy

B. The taxpayer is actively communicating about their inability to pay

C. All of the above

D. The taxpayer has recently lost their job

The IRS generally refrains from taking enforced collection actions in specific circumstances where it recognizes the taxpayer's situation may warrant leniency. One such condition is when the taxpayer is in bankruptcy. Under U.S. bankruptcy law, while a taxpayer is undergoing bankruptcy proceedings, an automatic stay is enacted, which temporarily halts collection efforts from creditors, including the IRS. This allows the taxpayer to reorganize their debts and come up with a repayment plan without facing immediate collection actions. Another relevant situation is when the taxpayer is actively communicating with the IRS about their inability to pay. When a taxpayer demonstrates a willingness to engage with the IRS, it often leads to alternative arrangements such as installment agreements or offers in compromise, rather than aggressive collection tactics. This communication signals to the IRS that the taxpayer is taking their tax obligations seriously and is seeking a manageable way to address their outstanding debts. Additionally, being recently unemployed may also factor into the IRS's decision-making but is typically not a standalone condition that guarantees an absence of enforced collection actions. The IRS may consider the totality of circumstances, including employment status, financial hardships, and communication efforts, in determining the appropriateness of collection actions. Thus, when both bankruptcy status and proactive communication about financial difficulties are present, the IRS is more

10. Which itemized deduction might exceed the standard deduction?

A. Mortgage interest payments

B. Child tax credits

C. Standard business expenses

D. Miscellaneous deductions

Mortgage interest payments can often exceed the standard deduction, making them a significant itemized deduction for many taxpayers. When a taxpayer has a mortgage, the interest paid on that loan can accumulate to a substantial amount over the course of the year, particularly in the early years of the loan where a larger portion of the mortgage payment is applied to interest. The standard deduction is a set amount that reduces the income on which a taxpayer is taxed. For many taxpayers, this deduction is beneficial, but for those with substantial mortgage interest, itemizing deductions can yield a lower taxable income. This is especially true in cases where taxpayers have purchased a home or taken out a significant mortgage, as the interest deduction can be considerable. In contrast, child tax credits, standard business expenses, and miscellaneous deductions do not typically reach a level that would consistently exceed the standard deduction for most taxpayers. Child tax credits directly reduce tax liability rather than being considered an itemized deduction. Standard business expenses relate to self-employment income and do not apply to individual itemized deductions on a personal return in the same way. Miscellaneous deductions are often subject to limitations and thresholds, making them less likely to exceed the standard deduction. Overall, mortgage interest payments stand out as a common itemized deduction that can

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