

Intuit Academy Tax Level 1 Practice Test (Sample)

Study Guide



Everything you need from our exam experts!

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SAMPLE

Questions

- 1. What is an exemption that allows a taxpayer to avoid the 10% penalty on a non-qualified Roth IRA distribution?**
 - A. Unreimbursed medical expenses over 7.5% of AGI**
 - B. Investment in non-qualified stocks**
 - C. Withdrawal for luxury purchases**
 - D. Proceeds from selling home**
- 2. What form must a sole proprietor complete with their federal income tax return?**
 - A. Form 1040**
 - B. Schedule C**
 - C. Form 1099-MISC**
 - D. Schedule SE**
- 3. What primary demographic do several federal tax credits aim to assist?**
 - A. High-income households**
 - B. Middle-income and low-income households**
 - C. Individuals with no dependents**
 - D. Small business owners**
- 4. Which of the following is used to reduce the amount of tax due?**
 - A. Tax deductions**
 - B. Tax credits**
 - C. Tax liabilities**
 - D. Tax rates**
- 5. Which of the following capital assets do not qualify for capital gains tax exclusion?**
 - A. Primary residence**
 - B. Collectibles**
 - C. Investment property held for rental**
 - D. Qualified small business stock**

- 6. How does AGI influence tax deductions?**
- A. It does not affect tax deductions**
 - B. It determines the eligibility for most deductions**
 - C. It reduces the overall tax liability directly**
 - D. It sets the tax deduction rate**
- 7. What is true regarding the compensation received by Levi for his work in the U.S.?**
- A. The compensation only requires reporting.**
 - B. It is fully taxable under U.S. tax law.**
 - C. The compensation requires allocation.**
 - D. It is non-taxable because he is a foreign resident.**
- 8. Which of the following is considered taxable income under miscellaneous income?**
- A. Wages from employer**
 - B. Royalties**
 - C. Dividends from stocks**
 - D. Interest from savings accounts**
- 9. Which items can typically contribute to gross income?**
- A. Charitable donations**
 - B. Retirement distributions**
 - C. Student tuition payments**
 - D. Health insurance premiums**
- 10. What does CFC stand for in tax terminology?**
- A. Controlled Foreign Corporation**
 - B. Certified Finance Corporation**
 - C. Common Federal Credit**
 - D. Cooperative Financial Company**

Answers

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

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Explanations

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1. What is an exemption that allows a taxpayer to avoid the 10% penalty on a non-qualified Roth IRA distribution?

A. Unreimbursed medical expenses over 7.5% of AGI

B. Investment in non-qualified stocks

C. Withdrawal for luxury purchases

D. Proceeds from selling home

A taxpayer can avoid the 10% penalty on a non-qualified distribution from a Roth IRA under specific circumstances, one of which includes using the funds for unreimbursed medical expenses that exceed 7.5% of their adjusted gross income (AGI). This exemption reflects the tax code's provisions that allow individuals to access their retirement savings in times of significant financial need, particularly for necessary medical care that goes beyond the reach of their insurance or other financial resources. The rationale behind this exemption is to provide relief to taxpayers who may face financial hardship due to healthcare costs, ensuring they aren't unduly penalized for accessing their own retirement savings to cover essential expenses. In contrast, the other options do not qualify as acceptable reasons for avoiding the 10% penalty: investment in non-qualified stocks doesn't relate to distributions, luxury purchases are not considered necessary expenses linked to the exemption criteria, and proceeds from selling a home do not influence the distribution rules governing Roth IRAs.

2. What form must a sole proprietor complete with their federal income tax return?

A. Form 1040

B. Schedule C

C. Form 1099-MISC

D. Schedule SE

A sole proprietor reports their business income and expenses on Schedule C, which is used to detail profit or loss from a sole proprietorship. This form allows the sole proprietor to calculate net earnings from their business, which is then transferred to their Form 1040, the individual income tax return. Schedule C becomes essential for sole proprietors because it is the primary means by which they report the income generated by their business activities, as well as any eligible expenses that can reduce that income, leading to a lower overall tax obligation. While Form 1040 is necessary for filing an individual tax return overall, Schedule SE, which is used to calculate self-employment tax, and Form 1099-MISC, which reports miscellaneous income, are not specifically for reporting the business income of sole proprietors in the same way that Schedule C is. Thus, Schedule C is the most accurate choice for indicating what form a sole proprietor must complete alongside their federal income tax return.

3. What primary demographic do several federal tax credits aim to assist?

- A. High-income households**
- B. Middle-income and low-income households**
- C. Individuals with no dependents**
- D. Small business owners**

Several federal tax credits are designed specifically to assist middle-income and low-income households because these individuals often face financial challenges that can impact their ability to support themselves and their families. The purpose of these tax credits is to provide financial relief and encourage economic stability among these demographics. For example, credits such as the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC) are specifically structured to benefit lower and middle-income families, helping to reduce their tax liability and potentially enhancing their income. These credits aim to alleviate poverty and support families in achieving greater financial security, thereby contributing to overall economic growth. The other options do not align with the intended demographics for these specific federal tax credits. High-income households, for instance, are typically not the target of such assistance programs, as they generally have the financial means to manage their living expenses without additional government support. Individuals with no dependents may also not benefit from credits designed for families, as many of these credits are contingent upon having children or dependents. Lastly, while small business owners do receive support through specific tax deductions and credits, the primary federal tax credits mentioned primarily focus on aiding households based on income level rather than business ownership status.

4. Which of the following is used to reduce the amount of tax due?

- A. Tax deductions**
- B. Tax credits**
- C. Tax liabilities**
- D. Tax rates**

The correct answer is tax credits because they directly reduce the amount of money a taxpayer owes to the government, effectively lowering their tax liability. When a taxpayer qualifies for a tax credit, it is subtracted from their total tax owed dollar-for-dollar, meaning if you owe \$1,000 in taxes and have a \$200 tax credit, your tax payment would only be \$800. Tax deductions, on the other hand, reduce the amount of taxable income, which can lower the overall tax bill, but not as directly or effectively as tax credits. Tax liabilities refer to the total amount of taxes owed by an individual or entity and do not actively reduce the amount owed; they represent the result of applying other elements such as deductions or credits. Tax rates influence how much tax is owed based on income levels and do not function to reduce taxes due. Tax credits are thus a more effective means of reducing tax obligations than the other options listed.

5. Which of the following capital assets do not qualify for capital gains tax exclusion?

- A. Primary residence**
- B. Collectibles**
- C. Investment property held for rental**
- D. Qualified small business stock**

The correct response is based on the understanding of capital gains tax exclusion rules as they apply to various types of capital assets. Capital gains tax exclusion primarily applies to certain asset categories when they are sold at a profit. Collectibles, such as art, antiques, stamps, and coins, do not qualify for the same favorable capital gains tax treatment as other capital assets. When collectibles are sold, they are subject to a maximum capital gains tax rate of 28%, which is higher than the standard rates applied to long-term capital assets such as stocks or real estate. This treatment reflects the tax code's specification that gains from collectible sales do not benefit from capital gains tax exclusion rules like the sale of a primary residence does. In contrast, a primary residence can qualify for a capital gains exclusion up to \$250,000 for individuals and \$500,000 for married couples filing jointly, provided they meet specific residency requirements. Similarly, investment properties held for rental and qualified small business stock can also benefit from more favorable tax treatments under certain conditions, further differentiating them from collectibles. Understanding these distinctions is fundamental for tax planning and compliance, particularly for individuals considering the sale of various types of assets.

6. How does AGI influence tax deductions?

- A. It does not affect tax deductions**
- B. It determines the eligibility for most deductions**
- C. It reduces the overall tax liability directly**
- D. It sets the tax deduction rate**

Adjusted Gross Income (AGI) plays a crucial role in determining eligibility for various tax deductions and credits. Many deductions and credits are phased out or limited based on the taxpayer's AGI. For example, certain itemized deductions, such as those related to medical expenses, are only deductible to the extent that they exceed a percentage of AGI. This means that a taxpayer with a lower AGI may be eligible for higher deductions compared to someone with a higher AGI. Additionally, specific tax credits, such as the child tax credit or education credits, also have AGI thresholds that impact eligibility and the amount a taxpayer can claim. Therefore, AGI serves as an important benchmark for assessing the availability and extent of various tax benefits, influencing the overall tax liability, even if not directly reducing it. On the other hand, the other choices do not accurately capture the role of AGI. While it is true that AGI does not directly set rates or itself reduce tax liability, its impact is seen in determining eligibility and the limitations placed on certain deductions and credits.

7. What is true regarding the compensation received by Levi for his work in the U.S.?

- A. The compensation only requires reporting.**
- B. It is fully taxable under U.S. tax law.**
- C. The compensation requires allocation.**
- D. It is non-taxable because he is a foreign resident.**

The compensation received by an individual for work performed in the U.S. is generally subject to U.S. tax laws. Option B correctly states that it is fully taxable under U.S. tax law, as compensation earned by employees working in the U.S. typically becomes taxable regardless of the worker's residency status. Option A suggests that the compensation only requires reporting, but this does not take into account the tax implications of the income earned; reporting is not sufficient if the income is taxable. The notion presented in Option D that the compensation is non-taxable because of Levi being a foreign resident is not accurate in most cases, as income earned for services performed in the U.S. is generally subject to taxation regardless of the worker's residency. Allocation of compensation can be relevant when determining how much income is taxable based on time spent working in various locations or under specific rules, but it does not capture the full scope of the tax obligation Levi has under U.S. tax law. Therefore, stating that the compensation requires allocation does not accurately reflect its taxability; it is more about how the income is treated under tax guidelines rather than an indication of a non-taxable status.

8. Which of the following is considered taxable income under miscellaneous income?

- A. Wages from employer**
- B. Royalties**
- C. Dividends from stocks**
- D. Interest from savings accounts**

Royalties are considered taxable income under miscellaneous income because they represent payments made to an individual for the right to use their intellectual property, such as copyrights, patents, and trademarks. This type of income does not fall under the category of regular employment wages, dividends, or interest, which have their own specific classifications for tax reporting purposes. In the context of taxes, miscellaneous income is typically categorized as income that does not fit neatly into predefined categories like wages or investment income. Therefore, royalties are specifically mentioned as taxable under miscellaneous income because they can arise from a variety of sources, like book or music sales, and are treated differently from routine employment-derived income or standard investment earnings. Understanding this distinction is crucial for accurate tax reporting and compliance.

9. Which items can typically contribute to gross income?

- A. Charitable donations
- B. Retirement distributions**
- C. Student tuition payments
- D. Health insurance premiums

Retirement distributions are a significant component of gross income for tax purposes. When individuals receive distributions from retirement accounts such as 401(k) plans or traditional IRAs, these amounts are generally included in gross income in the year they were received. This inclusion occurs because these distributions often consist of pre-tax contributions and earnings, which are subject to income tax upon withdrawal. In contrast, charitable donations do not contribute to gross income; they are generally considered outflows of cash and can instead provide deductions on tax returns. Student tuition payments also do not contribute to gross income. Instead, they may qualify for education tax credits or be deducted under certain conditions. Lastly, health insurance premiums are paid with after-tax dollars, and while they may qualify for deductions, they do not increase gross income. Therefore, retirement distributions stand out as the item that directly impacts gross income.

10. What does CFC stand for in tax terminology?

- A. Controlled Foreign Corporation**
- B. Certified Finance Corporation
- C. Common Federal Credit
- D. Cooperative Financial Company

CFC stands for Controlled Foreign Corporation in tax terminology. This term is significant in international tax law and relates to the categorization of foreign corporations that are controlled by U.S. shareholders. A Controlled Foreign Corporation is defined based on ownership thresholds—specifically, when more than 50% of the total combined voting power of all classes of stock or more than 50% of the total value of the stock of a foreign corporation is owned by U.S. shareholders. The designation of a corporation as a CFC has important tax implications for U.S. shareholders, including taxation on certain types of income, known as Subpart F income, even if that income is not repatriated back to the U.S. This provision aims to prevent tax deferral through the use of foreign entities and ensures that certain kinds of foreign income remain subject to U.S. taxation. The other choices do not hold relevance in the context of U.S. tax terminology. For instance, while certified finance institutions and cooperative financial companies do exist, they do not conflate with the significant tax-related impacts of controlled foreign corporations. Therefore, understanding the implications of CFC status is crucial for individuals and corporations involved in international business and tax compliance.