Liberty Tax School Practice Test (Sample)

Study Guide

BY EXAMZIFY

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<u>Questions</u>

1. What term is used to describe the basis of an item of property for figuring gain on a sale without considering earlier depreciation?

   A. Adjusted basis

   B. Fair market value

   C. Unadjusted basis

   D. Cost basis

2. Which of the following is NOT a criterion for determining material participation?

   A. Participating for more than 100 hours

   B. Participating less than any other individual

   C. Being involved regularly throughout the year

   D. Participating on a substantial basis

3. Which of the following illustrates a situation of passive activity participation?

   A. Involving oneself extensively in operational decisions

   B. Occasional involvement in planning meetings only

   C. Daily management of the business

   D. Active investment with delegated management

4. What is the salvage value of property?

   A. An estimated value of property when purchased

   B. An estimated value of property at the end of its useful life

   C. The market value of property at any point in time

   D. The initial cost of property before depreciation

5. What is constructive receipt of income?

   A. Received income that is not taxed

   B. Income made available to the taxpayer without restriction

   C. Income that can be deferred to future tax years

   D. Income that is only available upon request

6. Which of the following can reduce adjusted gross income?

- **A. Dependent exemptions**
- **B. Deductions for student loan interest payments**
- **C. Taxable capital gains**
- **D. Employment income**

7. What term refers to the period during which an asset is held for tax purposes?

- **A. Asset period**
- **B. Holding period**
- **C. Investment term**
- **D. Ownership duration**

8. Which type of asset can be considered part of a decedent estate?

- **A. Only personal items**
- **B. Real and personal property**
- **C. Only financial assets**
- **D. Liabilities and debts**

9. What may not impact the status of a household employee?

- **A. The payment method used**
- **B. The worker's full-time or part-time status**
- **C. The experience of the worker**
- **D. The agency used for hiring**

10. What is generally the time period covered by a tax return?

- **A. July 1 to June 30**
- **B. January 1 to December 31**
- **C. Any twelve consecutive months**
- **D. April 15 to April 14 of the next year**

Answers

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

Explanations

1. **What term is used to describe the basis of an item of property for figuring gain on a sale without considering earlier depreciation?**

   A. Adjusted basis

   B. Fair market value

   C. Unadjusted basis

   D. Cost basis

The term that describes the basis of an item of property for calculating gain on a sale, without taking into account any earlier depreciation, is referred to as the unadjusted basis. This basis represents the original cost of the property, which includes the purchase price and any additional costs associated with acquiring the asset, such as fees and taxes. In the context of property sales, the unadjusted basis is crucial for determining the gain or loss when the property is sold. By using the unadjusted basis, you maintain a clear view of the initial investment in the property prior to any depreciation adjustments that may have been taken in subsequent tax years. Other terms like cost basis and adjusted basis have specific definitions that involve alterations made to the original basis. The fair market value pertains to the price at which the property would sell on the open market and does not directly relate to the basis for calculating tax implications. Understanding these distinctions is essential for accurate tax reporting and compliance.

2. **Which of the following is NOT a criterion for determining material participation?**

   A. Participating for more than 100 hours

   B. Participating less than any other individual

   C. Being involved regularly throughout the year

   D. Participating on a substantial basis

Material participation is a key concept in tax law that helps determine whether an individual is actively involved in a business activity to a significant extent. This classification affects how income or losses from a business may be reported on tax returns. The criterion of participating less than any other individual does not align with the concept of material participation. For an individual to meet the threshold for material participation, they typically need to engage in the activity at least as much as any other individual involved in the business. If someone participates less than others, it suggests they are not materially participating in the activity. In contrast, the other criteria—participating for a significant number of hours, being involved regularly throughout the year, and participating on a substantial basis—align with the standards set by the IRS for assessing material participation. Each of these points reflects a deeper level of involvement that indicates the individual has a substantial, regular role in the business activity, which is crucial for tax reporting purposes.

3. Which of the following illustrates a situation of passive activity participation?

A. Involving oneself extensively in operational decisions

B. Occasional involvement in planning meetings only

C. Daily management of the business

D. Active investment with delegated management

Passive activity participation refers to a situation in which an individual is involved in a business or investment without significantly managing or controlling its operations. This typically means that the individual does not engage in the day-to-day management or decision-making processes of the business. Choosing the situation where someone is involved occasionally in planning meetings aligns perfectly with the concept of passive activity participation. This individual does not take a hands-on role in the daily operations and instead has limited involvement, which is characteristic of passive investors or participants. They may contribute to discussions or strategic decisions but are not responsible for the execution of those decisions or the management of the business. In contrast, options that depict extensive involvement in operational decisions, daily management, or active investment with delegated management indicate a high level of engagement and responsibility, which does not align with the definition of passive participation. These roles are marked by active decision-making and a strong presence in operational activities, distinguishing them clearly from passive involvement.

4. What is the salvage value of property?

A. An estimated value of property when purchased

B. An estimated value of property at the end of its useful life

C. The market value of property at any point in time

D. The initial cost of property before depreciation

The salvage value of property refers to the estimated value that an asset will realize upon its sale at the end of its useful life. This value is essential for accounting and financial calculations, particularly in determining depreciation. By estimating the salvage value, a business can spread the initial cost of the asset over its useful life while considering what the asset might still be worth when it is no longer in use. It's important to differentiate this from the initial purchase price or market value at various points in time. The initial cost is simply the amount paid for the asset, while market value reflects the asset's current value based on market conditions, which can fluctuate. Understanding salvage value is crucial for accurate financial planning and asset management, as it impacts the overall depreciation expense recorded in financial statements.

5. What is constructive receipt of income?

A. Received income that is not taxed

B. Income made available to the taxpayer without restriction

C. Income that can be deferred to future tax years

D. Income that is only available upon request

Constructive receipt of income refers to the tax principle stating that income is considered received by a taxpayer when it is made available to them without any restrictions, even if actual possession has not occurred. This means that if a taxpayer has the right to control and access the income, it must be reported for tax purposes, regardless of whether the taxpayer physically received the funds. In this context, if income is credited to the taxpayer's account, or if they have the ability to draw on it at their discretion, it constitutes constructive receipt. This principle prevents taxpayers from deferring income simply by delaying its actual possession, ensuring that all earned income is reported within the appropriate tax year. Therefore, the key aspect of constructive receipt is the taxpayer's access to the funds or income without any barriers or limitations.

6. Which of the following can reduce adjusted gross income?

A. Dependent exemptions

B. Deductions for student loan interest payments

C. Taxable capital gains

D. Employment income

The deduction for student loan interest payments is a specific tax benefit that allows taxpayers to reduce their adjusted gross income (AGI) by deducting a portion of the interest they have paid on qualified student loans. This deduction can help lower the overall tax burden by effectively reducing the income amount on which tax liability is calculated. Student loan interest deductions can be especially beneficial for individuals who are still repaying their student loans, providing relief during a time when they may have limited financial resources. The deduction is limited to a maximum amount per year and is subject to income phase-outs, meaning that as a taxpayer's income increases, the ability to claim this deduction may decrease. In contrast, other options listed do not have the same effect on AGI. Dependent exemptions have been eliminated in tax years following the Tax Cuts and Jobs Act, so they do not contribute to reducing AGI anymore. Taxable capital gains do not reduce AGI; instead, they increase the taxable income. Employment income, being a part of gross income, also contributes to AGI instead of reducing it. Thus, the deduction for student loan interest payments stands out as the legitimate method for reducing AGI among the choices provided.

7. What term refers to the period during which an asset is held for tax purposes?

A. Asset period

B. Holding period

C. Investment term

D. Ownership duration

The term that refers to the period during which an asset is held for tax purposes is known as the holding period. This term is significant in tax law as it determines whether the gain or loss from the sale of an asset is classified as a short-term or long-term capital gain or loss. The distinction is important because it affects the tax rates applied; typically, long-term capital gains are taxed at a lower rate than short-term gains. In tax scenarios, the holding period begins when the asset is acquired and ends when it is sold or disposed of. For most assets, if an individual holds the asset for more than one year, it qualifies for long-term capital gains treatment. Understanding the holding period can therefore have a substantial impact on an individual’s tax liability when they sell their investments or property. The other terms listed do not accurately reflect this specific tax-related definition. Asset period, investment term, and ownership duration may describe the timeframe in different contexts, but they do not carry the established tax connotation that "holding period" does in tax discussions.

8. Which type of asset can be considered part of a decedent estate?

A. Only personal items

B. Real and personal property

C. Only financial assets

D. Liabilities and debts

A decedent estate encompasses all the assets that an individual owns at the time of their death. This includes both real property, such as land and buildings, and personal property, which encompasses a wide range of items like vehicles, jewelry, artwork, and personal effects. By definition, real property refers to immovable assets such as homes or plots of land, while personal property includes movable items that are owned by the decedent. Thus, recognizing both types of assets in a decedent estate is crucial for accurately assessing the total value of the estate for purposes related to probate, distribution, and taxation. In contrast to the other options, which either limit the definition of an estate to one type of asset or include liabilities and debts, the comprehensive nature of a decedent estate captures the entirety of an individual's possessions, allowing for a complete evaluation of their estate upon their passing.

9. What may not impact the status of a household employee?

A. The payment method used

B. The worker’s full-time or part-time status

C. The experience of the worker

D. The agency used for hiring

The status of a household employee primarily revolves around factors such as their payment method, full-time or part-time classification, and the agency involved in hiring. The experience of the worker, while potentially relevant to the specifics of job performance or wage negotiations, does not inherently affect their classification as a household employee under tax laws. For tax purposes, a household employee is typically defined as a worker who performs services in or around a private residence, and this designation is influenced by specifics like the payment structure (whether they are paid on an hourly basis or a salary), their work hours, and the nature of their employment conditions. A household employee's classification is not altered by their level of experience; rather, it is more closely tied to the nature of their relationship with the employer and the conditions under which they work. Thus, while experience may play a role in the practical aspects of their employment, it is not a determining factor for their status as a household employee.

10. What is generally the time period covered by a tax return?

A. July 1 to June 30

B. January 1 to December 31

C. Any twelve consecutive months

D. April 15 to April 14 of the next year

The time period generally covered by a tax return is January 1 to December 31. This aligns with the calendar year, which is the standard reporting period for individual income tax returns in the United States. Most individuals in the U.S. report their income and expenses based on this twelve-month period, ensuring consistency and conformity with the fiscal year that many organizations and businesses also adhere to. Choosing a different period, such as July 1 to June 30 or any twelve consecutive months, is not typical for reporting individual income taxes. Additionally, the option of April 15 to April 14 of the next year does not reflect a common tax year structure; April 15 is merely the standard due date for filing the annual tax return, and it does not establish the period of income covered by the return.