

Tax Preparer Practice Exam (Sample)

Study Guide



Everything you need from our exam experts!

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SAMPLE

Questions

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- 1. Which group of taxpayers may have different standard deduction amounts?**
 - A. Those who are non-residents**
 - B. Taxpayers age 65 or older, or blind**
 - C. Taxpayers who claim dependents**
 - D. Individuals with business income**
- 2. How does employer assistance for child care expenses affect the child-care credit?**
 - A. Total expenses increase by the employer's contribution**
 - B. Total child care expenses must be reduced by any amounts paid by the employer**
 - C. It does not affect the child-care credit at all**
 - D. Child care expenses remain the same regardless of employer contribution**
- 3. What item must be reported on Schedule H?**
 - A. Investment income**
 - B. Household employment taxes**
 - C. Sales tax**
 - D. Interest income**
- 4. Which of the following is NOT a reason to claim exemption from withholding?**
 - A. Expecting no tax liability**
 - B. Having a refund in the previous year**
 - C. Having federal income tax liability in the previous year**
 - D. Claiming the same exemption as the previous year**
- 5. What is included in the basis of purchased property?**
 - A. Just the cash paid**
 - B. Cash paid plus fair market value of services and property traded**
 - C. Only closing costs**
 - D. Cash paid minus penalties**

- 6. What is the filing requirement for compensation of clergy members?**
- A. Standard tax withholding applies**
 - B. Self-employment tax is required**
 - C. No filing is required**
 - D. Full-time employees do not need to file**
- 7. When would a traditional IRA distribution be partly taxable?**
- A. If no contributions were made.**
 - B. For nondeductible contributions that must be reported on Form 8606.**
 - C. If the distribution exceeds \$10,000.**
 - D. When the IRA has both deductible and nondeductible contributions.**
- 8. What are the rates for the Saver's Credit based on filing status and modified AGI?**
- A. 5%, 10%, or 15%**
 - B. 10%, 20%, or 50%**
 - C. 15%, 25%, or 35%**
 - D. 20%, 30%, or 40%**
- 9. Which kinds of scholarships might not be taxable?**
- A. Scholarships for non-degree candidates.**
 - B. Scholarships spent for qualified educational expenses by degree candidates.**
 - C. All scholarships are taxable by default.**
 - D. Only academic scholarships are non-taxable.**
- 10. What are the two categories used to divide real property for MACRS purposes?**
- A. Residential and Commercial**
 - B. Residential and Nonresidential**
 - C. Industrial and Agricultural**
 - D. Urban and Rural**

Answers

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

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Explanations

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1. Which group of taxpayers may have different standard deduction amounts?

- A. Those who are non-residents**
- B. Taxpayers age 65 or older, or blind**
- C. Taxpayers who claim dependents**
- D. Individuals with business income**

Taxpayers age 65 or older, or those who are blind, qualify for an increased standard deduction amount when filing their federal income tax returns. The tax code provides additional standard deduction amounts to these individuals to account for the additional financial burdens that can come with age or visual impairments. For the tax year, there are specific additional amounts added to the standard deduction for each condition: being 65 or older or being blind. This ensures that taxpayers facing these circumstances are afforded a greater tax benefit, reflecting the recognition of their unique situations relative to younger or sighted taxpayers. Other groups of taxpayers, such as non-residents, taxpayers who claim dependents, or individuals with business income, have standard deductions that generally conform to the regular amounts established by the IRS, without the additional considerations that apply to seniors or the blind. Non-residents typically do not qualify for the standard deduction at all unless they meet specific criteria. Taxpayers claiming dependents can receive a different tax benefit, but it does not alter the standard deduction per se. Similarly, those with business income would report their income differently but wouldn't receive a unique standard deduction amount beyond what is standard for their filing status.

2. How does employer assistance for child care expenses affect the child-care credit?

- A. Total expenses increase by the employer's contribution**
- B. Total child care expenses must be reduced by any amounts paid by the employer**
- C. It does not affect the child-care credit at all**
- D. Child care expenses remain the same regardless of employer contribution**

Employer assistance for child care expenses directly impacts the total eligible expenses when calculating the child-care credit. Specifically, any contributions made by the employer towards child care must be subtracted from the total child care expenses incurred by the taxpayer. This adjustment is necessary because the child-care credit is designed to provide a tax benefit based on out-of-pocket child care expenses incurred by the taxpayer. If the employer contributes to those expenses, it effectively reduces the amount that the taxpayer actually pays. Therefore, only the out-of-pocket expenses that exceed any employer contributions are eligible for the credit. The rationale here is to prevent double-dipping, ensuring that taxpayers do not receive a credit for amounts that they did not actually pay themselves. By reducing the total child care expenses by the amounts paid by the employer, the calculation of the credit accurately reflects the taxpayer's financial responsibility for child care expenses. This is essential for determining the correct amount of the credit that a taxpayer can claim on their tax return.

3. What item must be reported on Schedule H?

- A. Investment income
- B. Household employment taxes**
- C. Sales tax
- D. Interest income

Schedule H is specifically designed for reporting household employment taxes. When an employer pays a household employee, such as a nanny, housekeeper, or gardener, they have certain tax obligations under the federal tax laws. These obligations include reporting and paying Social Security and Medicare taxes, as well as Federal Unemployment Tax Act (FUTA) taxes related to household employment. Household employers must report these taxes on Schedule H, which ultimately gets attached to their Form 1040 when they file their income taxes. This ensures that both the employers and the employees are in compliance with tax regulations regarding employment taxes in a household setting. The other options do not belong on Schedule H. Investment income, sales tax, and interest income are unrelated to household employment taxes and are reported on different forms or schedules as applicable. For example, investment income is typically reported on Schedule B, and sales tax would not be reported directly on the individual income tax return, as it relates more to sales tax returns or claims for refunds.

4. Which of the following is NOT a reason to claim exemption from withholding?

- A. Expecting no tax liability
- B. Having a refund in the previous year
- C. Having federal income tax liability in the previous year**
- D. Claiming the same exemption as the previous year

Claiming exemption from withholding is typically based on the expectation of future tax liability. If an individual expects no tax liability for the current year, they might choose to claim exemption from withholding. Additionally, individuals may claim exemption if they had a refund in the previous year, indicating that they paid more in taxes than they owed. The concept of having a federal income tax liability in the previous year does not justify claiming an exemption from withholding. In fact, having a tax liability suggests that the individual does have tax obligations, which contradicts the conditions necessary to claim such an exemption. Generally, claiming the same exemption as the previous year could also be justified if the circumstances regarding income and tax status have not changed. Thus, the presence of federal income tax liability in the previous year points toward the expectation of needing to pay taxes in the current year, rather than an exemption from withholding.

5. What is included in the basis of purchased property?

- A. Just the cash paid**
- B. Cash paid plus fair market value of services and property traded**
- C. Only closing costs**
- D. Cash paid minus penalties**

The basis of purchased property represents the total amount invested in the property and is crucial for determining gain or loss when the property is sold. It generally includes not just the cash paid for the property, but also any other consideration given, such as the fair market value of services or other property that may have been exchanged as part of the transaction. In this case, selecting the option that includes cash paid plus the fair market value of services and property traded accurately reflects the principle of total investment in the property. When you trade property or pay for services as part of the purchase, those amounts contribute to the basis because they represent additional value given to acquire the property. Recognizing these components of the basis is vital for tax implications, as a higher basis may reduce the taxable gain when the property is eventually sold. Thus, the correct answer encompasses both cash payments and other forms of compensation that effectively add to the overall cost basis of the property.

6. What is the filing requirement for compensation of clergy members?

- A. Standard tax withholding applies**
- B. Self-employment tax is required**
- C. No filing is required**
- D. Full-time employees do not need to file**

Clergy members typically have a unique tax situation when it comes to their compensation. They are generally considered self-employed for tax purposes, even if they receive a paycheck that appears to be similar to a regular employee's compensation. As such, they are required to pay self-employment tax on their earnings, which includes their wages as well as any additional income they may generate from activities such as officiating weddings or conducting funerals. This requirement stems from the IRS's classification of ministers and clergy as self-employed individuals, which means they are responsible for reporting their income and paying self-employment tax accordingly. In addition to self-employment tax, clergy members may also have withholding requirements, but their primary tax obligations differ significantly from those of traditional employees. Understanding this distinction is crucial for tax preparers, as it influences how clergy are advised on their tax filings and the payments they are obligated to make.

7. When would a traditional IRA distribution be partly taxable?

- A. If no contributions were made.**
- B. For nondeductible contributions that must be reported on Form 8606.**
- C. If the distribution exceeds \$10,000.**
- D. When the IRA has both deductible and nondeductible contributions.**

A traditional IRA distribution can be partly taxable under certain circumstances, particularly when there are nondeductible contributions involved. Contributions that are nondeductible do not provide a tax benefit when made and are, therefore, not taxed upon distribution. However, when distributions are taken from a traditional IRA that includes a mix of both deductible and nondeductible contributions, only the portion related to the nondeductible contributions can be tax-free. The balance, which is made up of deductible contributions and earnings, is taxable upon distribution. To accurately report the nondeductible contributions and the corresponding taxable amount, taxpayers must use Form 8606. This form plays a crucial role in tracking how much of the account possesses nondeductible contributions, ensuring that taxpayers are not taxed twice on money they have already contributed after tax. The other choices present scenarios that do not accurately capture the circumstances under which a traditional IRA distribution would be partly taxable. For instance, not making any contributions at all does not directly impact taxation on a distribution, nor does the amount exceeding \$10,000 inherently create tax liability. Lastly, while an account having both deductible and nondeductible contributions indicates the potential for a partial taxation scenario, without the proper reporting of nondeductible contributions on Form 8606

8. What are the rates for the Saver's Credit based on filing status and modified AGI?

- A. 5%, 10%, or 15%**
- B. 10%, 20%, or 50%**
- C. 15%, 25%, or 35%**
- D. 20%, 30%, or 40%**

The Saver's Credit, also known as the Retirement Savings Contributions Credit, is designed to incentivize low- to moderate-income individuals to save for retirement by providing a tax credit based on contributions to retirement accounts. The rates for the Saver's Credit are associated with the taxpayer's filing status and modified adjusted gross income (AGI). The correct set of rates for the Saver's Credit is 10%, 20%, or 50%. This means that the percentage of the credit a taxpayer can claim varies depending on their income level and filing status. For example, the highest credit rate of 50% is available to the lowest-income individuals, with the percentage decreasing as income increases. The rates effectively encourage savings as income thresholds increase. Understanding these percentages is crucial for tax preparers, as clients may be eligible for different credit amounts based on their specific financial situations and contributions to qualified retirement plans. Being aware of how modified AGI affects eligibility and the credit rate allows tax preparers to advise clients accurately and maximize their tax benefits.

9. Which kinds of scholarships might not be taxable?

- A. Scholarships for non-degree candidates.
- B. Scholarships spent for qualified educational expenses by degree candidates.**
- C. All scholarships are taxable by default.
- D. Only academic scholarships are non-taxable.

Scholarships that are used for qualified educational expenses by degree candidates are generally not taxable. These qualified expenses include tuition, required fees, books, supplies, and equipment necessary for a course of study. When the scholarship is applied to these specific expenses, it is typically excluded from the recipient's gross income under IRS guidelines, allowing the student to benefit from the financial assistance without facing tax implications. The distinction here is important because not all scholarships are treated the same way under tax law. For example, scholarships received for non-degree candidates may not meet the criteria for non-taxable status, as they do not align with the educational expenses associated with a pursuit of a degree. Similarly, the assertion that all scholarships are taxable is inaccurate, as there are specific exemptions for those that meet the criteria of qualified educational expenses. Finally, stating that only academic scholarships are non-taxable overlooks other types of scholarships that may also provide non-taxable benefits if they're used for qualified expenses. Therefore, the specific focus on scholarships used for qualified educational expenses by degree candidates accurately reflects current tax principles.

10. What are the two categories used to divide real property for MACRS purposes?

- A. Residential and Commercial
- B. Residential and Nonresidential**
- C. Industrial and Agricultural
- D. Urban and Rural

For Modified Accelerated Cost Recovery System (MACRS) purposes, real property is categorized into two distinct groups: residential and nonresidential. This classification is vital because it determines the depreciation methods and recovery periods applicable to different types of real property. Residential property typically includes rental properties, apartments, and similar assets where people reside. Under MACRS, residential property is depreciated over a 27.5-year recovery period using the straight-line method. Nonresidential property encompasses a broader range of structures, including offices, retail stores, and warehouses, which are depreciated over a 39-year recovery period using the same straight-line method. This distinction is crucial for tax preparers, as it influences how clients may claim depreciation on their tax returns, reflecting the asset's wear and tear over its useful life in a tax-compliant manner. By properly classifying real property in line with these categories, tax professionals can ensure accurate reporting and adherence to IRS regulations, maximizing potential tax benefits for their clients.