

IRS

Enrolled Agent

Exam Study Guide

INCLUDES

- Part 1: Individuals
- Part 2: Businesses
- Part 3: Representation, Practice and Procedures.

SPECIAL BONUS

FREE access to our online question bank

<http://FastForwardAcademy.com>

FOR TEST PERIOD

2012 – 2013

FASTFORWARD ACADEMY



Rain Hughes, CFP® EA

Learn Fast and Pass

IRS Enrolled Agent Exam Study Guide

The comprehensive guide to passing the IRS Special Enrollment Examination
For testing period May 1, 2012–February 28, 2013

Rain Hughes, CFP® EA

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FAST FORWARD ACADEMY

About Us

Fast Forward Academy, LLC provides companies and individuals around the world with the tools to manage their professional education needs efficiently. Our principal focus is to supply rapid training and streamlined continuing education to professionals in the fields of taxation, securities, and insurance. The name “Fast Forward Academy” reflects the scope of our mission—helping students and professionals accomplish more in less time. To realize this goal, we make every effort to provide the most useful and efficient exam prep material in the marketplace, all designed to help our students *Learn Fast and Pass*.

FREE Online Question Bank

Register online at fastforwardacademy.com and gain access to a number of free resources that will help you prepare for your exam. In addition to our free online question bank, we have a variety of tools to help you measure your performance and overall readiness to sit for the exam:

- The **momentum indicator** displays your overall performance trend.
- Discover how you measure up against other users with our **Community vs. You** feature.
- Track your **study time**, including time per question.
- Our **section analysis** report helps you understand your weak areas.
- The **answers report** tracks each question, answer, and rationale that you see.
- The **opportunities filter** allows you to focus on topics with an emphasis on weak areas.

Practice Exams

How will you know when it is time to take each exam? Take a practice exam! Using our advanced testing platform, you can create simulated exams for each part of the Special Enrollment Exam (SEE). Once you complete an exam, you can access numerous analytics and reports to measure your performance.

- **We Provide Feedback.** See how you measure up against the community, and track your progress with detailed analytics. Every answer is tracked to measure your progress.
- Move from question to question as needed—forward, backward, or jump to a specific question.
- An exact timer keeps track of the total test time to measure how fast you answer each question.
- Reports provide performance results, rationale, correct answers, and all the important metrics you need to *Learn Fast and Pass*:
 - 1) **EA Exam Analysis Report:** View your performance and compare yourself to the community for each section of the SEE. This report includes performance details specific to subjects covered on the exam. Areas of weakness are highlighted so you know where to focus your time efficiently.
 - 2) **EA Exam Answers Report:** View completed exams and dive into specific questions, answers, and rationale.
 - 3) **EA Exam Time Report:** View overall time and other metrics for each SEE exam you take. The community is also measured so you can see how your time per question compares to others taking practice SEE exams.

Preface

The use of the singular male pronoun throughout this text is not intended to suggest any gender bias. It is used to make the text easier to read. In every instance, the word “he” should be understood to refer equally to “he or she.” Likewise, all references to singular taxpayers should be understood to refer to plural taxpayers, such as joint filers or married persons filing separately, except where it is specified or clear from the context that only the singular reference is appropriate.

Introduction

Thank you for choosing our *IRS Enrolled Agent Exam Study Guide*. This course, along with our **FREE** online question bank, will provide you with everything you need to pass the IRS Special Enrollment Exam. We designed our course to save you time, utilizing the experience of Enrolled Agents, CPAs, and former IRS employees. It provides only the *essential* material you need to pass the test and leaves out unnecessary information that would only bog you down. Our course is half the size ... on purpose!

Outline Format for Study-Efficiency

The IRS has a “study kit”¹ for the exam that lists 112 separate forms, form instructions, and publications that “provide much of the basic information to assist you in preparing for the examination.” There are thousands of pages within these documents, yet not one is designed to help you prepare for the exam. While the information within these publications may appear overwhelming, you do not need to remember it all to pass.

In the field of taxation, there are often exceptions, additional details, or extenuating circumstances that could affect a situation. While this course is comprehensive, it does not include every rule (or variation of a rule) that “could” appear on the exam. This is intentional. Spending time on rules that do not show up on the exam will not help you pass. In this course, we cover the relevant information you must know to pass. If you stray too far from the path, you risk losing focus on the important details needed for success.

The chapters within our study guide contain comprehensive outlines whenever possible. This format helps you better *visualize* and *retain* the important points of each section, resulting in maximum study efficiency and reduced study time. Each chapter is followed by a practice quiz (and detailed explanation) to help you fully comprehend the subject matter.

¹ <http://www.irs.gov/taxpros/agents/article/0,,id=109302,00.html>

Your Best Strategy to Pass

Study for One Exam at a Time

The Special Enrollment Exam (SEE) is a three-part exam, each with 100 questions. You will take each part separately. Do not study for all three exams at once. Pass one exam, and then move on to the next one. If you are like most people, you will probably study the Individuals (Part 1) exam first. Part 2 is the most challenging of the three exams, so after you pass Part 1, we suggest you take the representation exam next. There is much less content to study, and passing it can give you a boost of confidence going into the last exam. The IRS does not require you to take the tests in any particular order.

The Best Way to Use the Study Guide and the FREE Online Test Bank to Study Each Part of the Exam

We believe that in order to pass the IRS Special Enrollment Examination (SEE) to become an Enrolled Agent (EA) a student must have a solid strategy that reviews the material, provides access to drill questions with answers and explanations, and then allows for exam simulation to test readiness. The best way to Learn Fast and Pass is to use the Fast Forward Academy tools as follows:

Using the Test Bank:

- Begin by selecting one of the three exam parts to study. You can select Individuals, Businesses, or Representation, Practice and Procedures (RPP).
- Next, start reading the study guide for that section, one chapter at a time. Take the chapter quiz at the end of each chapter.
- Before continuing to the next chapter, access our FREE Test Bank – available at fastforwardacademy.com (an Enhanced Test Bank is also available).
- Use the Chapter filter to select questions based on the specific chapter you are studying. Use the Repeat filter to select only new questions, questions you got wrong, or any question.
- After answering each question, review the correct answer and explanation to confirm you are on the right track. Be sure to read the explanation, even for questions you answer correctly, as each explanation may contain additional test tips. The explanations include chapter references where you can further review the concept. The subjects in certain “bonus” questions are either covered in multiple chapters or do not appear in the book.
- Repeat the steps above until you are through with all chapters for the exam part you are studying.
- Your goal should be to score around 80% in the test bank prior to moving on to practice exams*
- Each exam part is divided into sections and weighted. As you answer questions by chapter, your Section analysis (found on your dashboard) is also being populated. Use the Section filter to focus on topics which may be covered in multiple chapters but which fall under similar categories.

*You may choose to take an exam before you start studying. Benefits of taking a practice exam first include allowing seasoned professionals to pinpoint study time to specific areas of weakness, as well as providing the ability to watch scores improve while studying the material. Taking a practice exam first is not a requirement.

Now it is time to take a Practice Exam:

- Proceed to the Practice Exam dashboard. Click Create Exam and then select the Exam part you wish to practice. To begin the exam, click Start Exam
- Practice exams simulate the real test in number of questions, subject weighting and time. You can easily navigate through the questions, and you can mark a question for later review.
- You may complete a Practice Exams in one sitting, or you can save and exit, returning to the exam later to finish. Keep in mind that any unanswered questions are marked as incorrect.
- Upon completion, you must mark the exam as Finished and return to the Practice Exam dashboard to receive your grade.
- Now you can use the Reports button to see a comprehensive breakdown of the subjects needing the most attention. Items in pink indicate scores of less than 25%

Using the Test Bank – Step 2:

- Following a Practice Exam, you now have additional tools to aid you with your studies. Return to the Test Bank and click the Go To Step 2* link (located just above the question filters)
- From this step you can interact directly with the questions from your practice exams. By clicking the Opportunities filter you have access to all of the topics tested, listed in order of weakest to strongest performance. © 2010 Fast Forward Academy, LLC.
- Select a topic from the Opportunities list (items in pink indicate less than 25%) and set the Repeat filter to “Yes, give me any question.”
- You may also use the Practice Exam filter to select a specific exam and interact with the questions from that test. In this instance, setting the Repeat filter to “Only questions I got wrong” allows you to focus on the most challenging exam questions.

*You can return to Step 1 at any time by clicking the Go back to Step 1 link

Our Best Strategy to Pass is a proven study method which garners excellent results. While the steps above can be executed in various manners, following this prescribed method will help facilitate successful completion of the IRS Special Enrollment Examination.

About the IRS Special Enrollment Exam

The EA Exam, officially known as the Special Enrollment Examination (SEE), is a three-part exam administered by Prometric on behalf of the Internal Revenue Service. You will take each part as a separate, 100-question exam. You will have up to 3 1/2 hours to complete each exam, which equates to just over two minutes per question.

Part 1 – Individuals	Percent of Exam
Section 1: Preliminary Work and Taxpayer Data	15%
Section 2: Income and Assets	25%
Section 3: Deductions and Credits	25%
Section 4: Taxation and Advice	20%
Section 5: Specialized Returns for Individuals	15%
TOTAL	100%

Part 2 – Businesses	Percent of Exam
Section 1: Businesses	45%
Section 2: Business Financial Information	40%
Section 3: Specialized Returns and Taxpayers	15%
TOTAL	100%

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Part 3 – Representation, Practices, and Procedures	Percent of Exam
Section 1: Practices and Procedures	33%
Section 2: Representation before the IRS	25%
Section 3: Specific Types of Representation	25%
Section 4: Completion of the Filing Process	17%
TOTAL	100%

A new examination period commences each year on May 1 and continues through February 28 of the following year. No testing occurs during March or April. The period that begins on May 1, 2012, will include questions based on the 2011 tax year. A passing score on each part of the exam is required before the IRS will admit an enrolled agent to practice. Scaled scores are determined by ranking your exam results against others taking the exam, on a scale ranging between 40 and 130. A score of 105 is the minimum required to pass. Test results are available immediately following the exam. Those who pass are informed, but they do not receive a score. Those who fail receive a score and a diagnostic report indicating the areas of weakness. A candidate may re-take each part up to four times during each testing period. Once a candidate passes the first part, he must pass the other two parts of the exam during a two-year window.

How to Register for the IRS Special Enrollment Exam

To schedule an exam, you need a Preparer Tax Identification Number (PTIN). To obtain a PTIN, you must complete a W-12 by mail, fax, or online at www.irs.gov. The PTIN user fee is \$64.25. The online method is quickest and provides you with the instantaneous issuance of the PTIN.

Examinations are administered by computer at Prometric testing centers. Currently, the Special Enrollment Examination is given at nearly 300 Prometric testing centers located across the United States and internationally. Test centers are located in most major metropolitan areas. Once you have your PTIN, you may register for your exam online at www.prometric.com/irs.

Question Types

The IRS Special Enrollment Exam contains only multiple-choice questions. Each provides four options from which you choose your answer. Three different multiple-choice formats are used.

Format 1 – Direct question

Which of the following entities are required to file Form 709, U.S. Gift Tax Return?

- A. An individual
- B. An estate or trust
- C. A corporation
- D. All of the above

Format 2 – Incomplete sentence

Supplemental wages are compensation paid in addition to an employee's regular wages. They **do not** include payments for the following:

- A. Accumulated sick leave
- B. Nondeductible moving expenses
- C. Vacation pay
- D. Travel reimbursements paid at the Federal Government per diem rate

Format 3 – All of the following except

There are five tests that must be met for you to claim an exemption for a dependent. Which of the following is **not** a requirement?

- A. Citizen or Resident Test
- B. Member of Household or Relationship Test
- C. Disability Test
- D. Joint Return Test

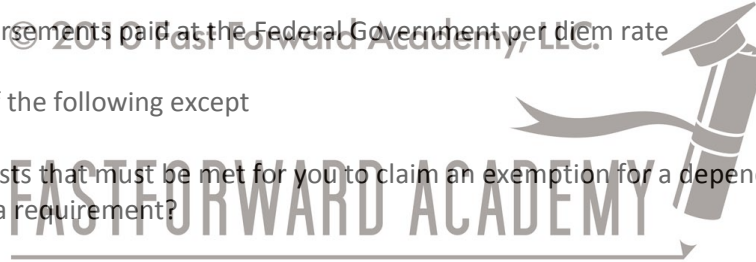


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SEE Exam Part 2 Businesses



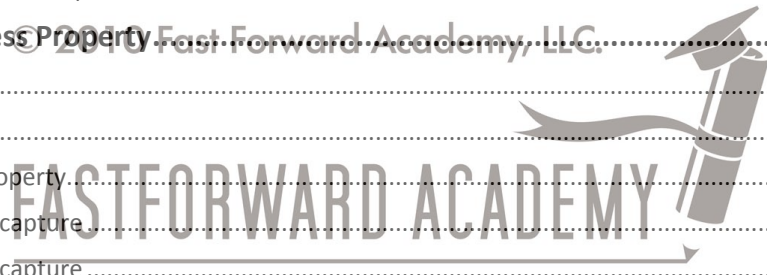
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1

Filing Information

General Requirements · Accounting Periods and Methods · Filing Requirements · Tax Withholding and Estimated Tax · Filing Status · Personal Exemptions and Dependents

This chapter summarizes some of the general rules and requirements contained in IRS Publication 17 and Form 1040 instructions regarding the preparation of U.S. Federal Income Tax Returns.

General Requirements

Social Security Number

Enter a valid *Social Security number* (SSN) for all parties on the return, including each dependent claimed. If no SSN is available, list the *individual taxpayer identification number* (ITIN) or *adoption taxpayer identification number* (ATIN) when applicable. If a child was born and died in the same year and a taxpayer does not have an SSN for the child, he may attach a copy of the child's birth certificate, death certificate, or hospital records instead. The document must show the child was born alive.

Filing Deadlines

The income tax return is due by the 15th day of the 4th month after the close of the tax year. Usually, this falls on April 15. If the due date falls on a Saturday, Sunday or legal holiday, the due date is delayed until the next business day. The IRS considers a paper return "on time" when it arrives with a proper address and sufficient postage and bears a postmark on or before the due date. A return sent using IRS e-file is on time if the *authorized electronic return transmitter* postmarks the transmission by the due date.

Filing a Claim for Refund

The normal deadline for filing a claim for refund or credit is three years from date for filing the original return or two years after paying the tax, whichever is later. The IRS treats payments or returns made before the due date—without regard to extensions—as received on the due date. For example, the return of a taxpayer who files his return March 1 is considered filed on the due date of April 15. However, if he had an extension to file (for example, until October 15) but files earlier and the IRS receives it July 1, the return is considered filed on July 1.

If a claim is filed within three years after the date of filing the return, the credit or refund cannot be more than the part of the tax paid within the three-year period (plus any extension of time for filing the return) immediately before the claim was filed. A notable exception to the 3-year rule is an amended return based on a bad debt or worthless security, which generally must be filed within seven years after the due date of the return for the tax year in which the debt or security became worthless.

Extensions

A taxpayer may file Form 4868 to request an ***automatic six-month extension*** (via paper or electronically) by the due date of the return or by paying all or part of the income tax due using a credit or debit card.

For most taxpayers, this extends the due date until October 15. Please note that this is NOT an extension of time to pay taxes. Taxpayers must estimate the taxes due and submit the payment with the request.

- **Serving in a Combat Zone** – When individuals serve in a qualified combat zone, the filing deadline increases by 180 days after the latter of the last day in a qualified combat zone or the last day of a continuous hospitalization related to injury from service. In addition to the 180 days, a service member in a qualified combat zone can receive a deadline extension of up to three and a half months, based on the number of days remaining to file upon entering the combat zone. This period is representative of the time normally allotted for filing taxes (January 1–April 15). If entering the combat zone before the first of the year, the service member may add the entire three and a half months to the 180-day extension.
- **Individuals Outside the United States** – A taxpayer who is a U.S. citizen (or resident) may receive an automatic two-month extension to file a return and pay any federal income tax due if—on the due date of the return—he is in the military or naval service on duty outside the United States and Puerto Rico, or lives and maintains a main place of business outside the United States and Puerto Rico. Interest applies from the due date until paid. The taxpayer must attach a statement to his return explaining which situation applies.

Accounting Periods and Methods

The typical period covered by personal income tax returns is the 12-month period from January 1 through December 31, also known as a *calendar year*. A *fiscal year* is another typical accounting period. A regular fiscal year is a 12-month period that ends on the last day of any month except December. A taxpayer will choose the type of accounting period (tax year) when he files his first income tax return.

Cash Method

Most individual taxpayers use the *cash method*. If this method is used, the taxpayer must report interest income in the year of *constructive receipt*. Constructive receipt occurs when the income is available for a taxpayer's unrestricted withdrawal. Physical possession is not a requirement. Examples of constructive receipt include the following:

- Garnished wages (considered income received for the year)
- Debt canceled or paid for a taxpayer but not as a gift or loan (gross income to the recipient)
- Income payments paid directly to a third party from property owned by a taxpayer (treated as received by the taxpayer and paid to the third party)
- Income paid in advance (includable in gross income for the year received)
- Checks received and available to the taxpayer without restriction

Exception: Do not report interest on Series E and EE U.S. savings bonds until the final maturity date.

Accrual Method

Another method is the *accrual method*. When using the accrual method, report interest income when earned, whether the taxpayer has received it or not. The IRS considers the taxpayer to have earned income when all the events have occurred that fix the right to receive such income and the amount can be determined with reasonable accuracy.

Filing Requirements

Individuals

The **gross income threshold** determines whether the taxpayer must file a return. It is the sum of the standard deduction and personal exemption amounts for each filing status. If gross income is not greater than the allowable deductions, the taxpayer need not file a return. See Table 1-1.

Table 1-1. 2011 Filing Requirements for Most Taxpayers

IF filing status is...	AND at the end of 2011, the taxpayer was ...	THEN file a return if the gross income was at least ...
Single	younger than 65	\$9,500
	65 or older	\$10,950
Married Filing Jointly	younger than 65 (both spouses)	\$19,000
	65 or older (one spouse)	\$20,150
	65 or older (both spouses)	\$21,300
Married Filing Separately	any age	\$3,700
Head of Household	younger than 65	\$12,200
	65 or older	\$13,650
Qualifying Widow(er) with Dependent Child	younger than 65	\$15,300
	65 or older	\$16,450

Dependents

Factors such as marital status, age, income, and blindness affect the need for a dependent to file a return. Dependents must file individual returns under the circumstances described in Table 1-2. **Earned income** includes salaries, wages, tips, professional fees, taxable scholarships, and fellowship grants. **Unearned income** includes unemployment compensation, taxable Social Security benefits, taxable pensions, annuity income, canceled debt, unearned income from a trust, taxable interest, dividends, and capital gains. **Gross income** is the total of *earned* and *unearned income*.

Table 1-2. 2011 Filing Requirements for Single Dependents

Single dependents – Were you either age 65, older, or blind?
<input type="checkbox"/> No. You must file a return if any of the following apply. <ul style="list-style-type: none"> • Your unearned income was more than \$950. • Your earned income was more than \$5,800. • Your gross income was more than the larger of: <ul style="list-style-type: none"> - \$950, or - Your earned income (up to \$5,500) plus \$300.
<input type="checkbox"/> Yes. You must file a return if any of the following apply. <ul style="list-style-type: none"> • Your unearned income was more than \$2,400 (\$3,850 if 65 or older and blind). • Your earned income was more than \$7,250 (\$8,700 if 65 or older and blind). • Your gross income was more than the larger of: <ul style="list-style-type: none"> - \$2,400 (\$3,850 if 65 or older and blind), or - Your earned income (up to \$5,500) plus \$1,750 (\$3,200 if 65 or older and blind).

Certain Children Younger than 19 Years of Age or Full-time Students

Parents can elect to include a child's income on the parent's return (Form 8814) when a child's only income is interest, dividends or capital gain distributions. If making this election, the child does not have to file a return. The child must meet the following conditions to qualify:

- At the end of the year, must be younger than age 19 or a full-time student younger than age 24
- Must have gross income of less than \$9,500
- Must be required to file a return unless the election is made
- Must not file a joint return for the year
- Must not have made estimated tax payments for the tax year, and no overpayment from the previous year can apply to the tax year under his name and Social Security number
- Must not have any federal income tax taken out of his income under the backup withholding rules

Additional Filing Requirements

A taxpayer is required to file a return if any of the four conditions listed below apply, even if income is less than the amount shown in Table 1-1 or Table 1-2:

- Special taxes are owed, or certain credits must be recaptured
- The taxpayer received earned income credit (EIC) payments from an employer in advance
- Net earnings from self-employment are at least \$400
- Wages are \$108.28 or more from a church or qualified church-controlled organization that is exempt from employer Social Security and Medicare taxes

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Aliens

The IRS considers a **resident alien** (not a U.S. citizen) as someone who spends more than 183 days in the United States during the tax year or has a "green card." Resident aliens must file a tax return following the same rules that apply to U.S. citizens. A **nonresident alien** must file special forms and adhere to a different set of rules. Most U.S. source income a nonresident alien receives is subject to withholding with a tax rate of 30%. A nonresident who receives U.S. income must file a return (Form 1040-NR) if additional taxes are due or if conducting a business in the U.S. A nonresident alien who is married to a U.S. citizen or resident at the end of the year can choose tax treatment as a U.S. resident.

Tax Withholding and Estimated Tax

Federal income tax is a "pay-as-you-go" system. Failure to pay or a significant under-estimation of the amount owed may lead to the assessment of penalties and interest. There are two payment methods, withholding and estimated tax.

Withholding

An employer withholds income tax from an employee's pay and deposits with the IRS in the name of the employee. Individuals may withhold tax on other income sources like pensions, bonuses, commissions, and gambling winnings. In order to determine the proper amount of withholding, an employee

completes form W-4 indicating the number of exemptions and provides the form to the employer. Employers do not send the form to the IRS, unless requested in writing.

Estimated Tax

Income from dividends, interest, capital gains, rent, royalties, and self-employment is not subject to withholding. A taxpayer with income from these sources is required to estimate liability and deposit quarterly payments. The IRS may issue a penalty even if a refund is due when a sufficient amount of tax is unpaid by the due date for each of the periods as indicated below (next business day if on holiday).

For the period:	Due date:
Jan. 1–Mar. 31 (3 months)	April 15 (fourth month)
Apr. 1–May 31 (2 months)	June 15 (sixth month)
Jun. 1–Aug. 31 (3 months)	September 15 (ninth month)
Sep. 1–Dec. 31 (4 months)	January 15 (first month following tax year)

An individual with no tax liability in the previous full year is not required to pay estimated tax. Estimated tax liability exists when both the following conditions exist:

- Individuals will owe at least \$1,000 in tax, after subtracting withholding and credits
- Withholding and credits will be less than the smaller of one of the following:
 - 1) 90% of the tax to be shown on this year's tax return
 - 2) 100% of the tax shown on last year's return (110% if AGI more than \$150,000)

Filing Status

In general, filing status depends on marital status. A person is considered unmarried for the whole year if, on the last day of the tax year, he is unmarried or legally separated from a spouse under a divorce or separate maintenance decree. If a spouse dies during the year, the IRS considers the surviving spouse married for the whole year and allows married filing jointly as the filing status.

Single (S)

An individual is "single" if, on the last day of the year, he is unmarried or legally separated from a spouse under a final court decree and does not qualify for another status.

Head of Household (HH)

Filing as **head of household** usually results in lower tax rates than those for single or married filing separately. To qualify, a person must be unmarried or **considered unmarried** (file a separate return and spouse did not live in home the last 6 months of the tax year) on the last day of the year and pay more than half the cost of keeping up a home for the year. A **qualifying person** must live with the taxpayer more than half of the year, with the exception of a mother or father. A **qualifying person** must be a **qualifying child** or **qualifying relative** for whom the taxpayer can claim an exemption. A qualifying relative must be a member of the taxpayer's family (not merely a member of the household) in order to be a qualifying person for this status. The taxpayer must pay more than half the cost of maintaining the parent's home (or the cost of a facility), if claiming based on a dependent parent.

Married Filing Jointly (MFJ)

Taxpayers may choose **married filing jointly** as the filing status if they are married and agree to file a joint return. Both are responsible, jointly and individually, for the tax and any interest or penalty due. While different accounting methods are allowable, both must use the same accounting period and are generally required to sign the return. All combined income and allowable expenses must be reported. They may file a joint return even if one spouse has no income or deductions. When a court decree of annulment reverses a marriage, they must amend previous joint returns. If one spouse is a nonresident alien, they must have either a SSN or an ITIN to file a joint return.

Married Filing Separately (MFS)

Married couples can choose **married filing separately** as a status if they want to be responsible only for their respective taxes. They will *usually* pay more total tax on separate returns than when using another filing status. When choosing this filing status, the following special rules apply:

- Cannot take the credit for child and dependent care expenses in most cases, and the limit on income excluded under an employer's dependent care assistance program is \$2,500.
- No earned income credit.
- No exclusion or credit for adoption expenses in most cases.
- Cannot take the education credits (Lifetime Learning or American Opportunities), the deduction for student loan interest, or the tuition and fees deduction.
- No exclusion on interest income from U.S. savings bonds when used for education expenses.
- If the taxpayer lived with a spouse at any time during the tax year, the following conditions apply:
 - 1) Cannot claim the credit for the elderly or the disabled
 - 2) Must include in income more (up to 85%) of any Social Security the taxpayer received
- The *child tax credit* and *retirement savings contribution credit* reduce at a level of income equal to one-half of the amount allowable to joint filers.
- The deduction limit for a capital loss is \$1,500 (instead of \$3,000 for joint returns).
- The first-time homebuyer credit is limited to \$4,000 (instead of \$8,000 for joint returns).
- The standard deduction is half that allowed to joint filers. If one spouse itemizes deductions, the other cannot claim the standard deduction.
- The exemption amount for the alternative minimum tax is half that allowed to joint filers.

Qualifying Widow(er) with Dependent Child (QW)

If one spouse dies during the tax year, the survivor can file jointly (MFJ) if he otherwise qualifies for that status. The year of death is the last year to file jointly with a deceased spouse. In certain cases, **qualifying widow(er) with dependent child** is the filing status for two tax years following the year a spouse died. This filing status entitles them to use joint return tax rates and the highest standard deduction amount (if not itemizing deductions). To file as a qualifying widow(er) with dependent child, a taxpayer must meet all of the following tests:

- Must be entitled to file a joint return with his spouse for the year the spouse died

- Must not remarry before the end of the tax year
- Must have a child or stepchild (not a foster child) for whom he can claim an exemption
- A child lived in the person's home all year, except for temporary absences
- The taxpayer and the deceased spouse paid more than half of the cost of maintaining a home

Personal Exemptions and Dependents

There are two types of exemptions: *personal exemptions* and *exemptions for dependents*. While each is worth the same amount (**\$3,700 for 2011**), different rules apply. In 2011, taxpayers will not lose any part of the deduction for exemptions, regardless of AGI.

Personal Exemptions

Single taxpayers generally receive one *personal exemption*. If another taxpayer can claim an individual as a dependent, that individual is unable to claim a personal exemption. This is true even if the other taxpayer does not actually claim him as a dependent.

- **Joint return (MFJ)** – An additional exemption is available for a spouse.
- **Separate return (MFS)** – On a separate return, claim an additional exemption for a spouse who has no gross income, does not file a return, and is not the dependent of another taxpayer.
- **Death of spouse** – If a spouse dies and the surviving spouse does not remarry that year, the survivor can claim an exemption for the deceased spouse. An individual without gross income who remarries in the year of a spouse's death can be claimed as an exemption on both the final separate return of a deceased spouse and the separate return of a new spouse. If filing a joint return with a new spouse, the exemption is appropriate only for that return.
- **Divorced or separated spouse** – An exemption for a former spouse is not available in the year a decree of divorce or separate maintenance is final. This rule applies even for those who provide all of a former spouse's support.

Exemptions for Dependents

To claim an exemption for a dependent, a taxpayer must meet all three of the following tests:

- **Dependent Taxpayer Test** – The taxpayer cannot qualify as a dependent of another person.
- **Joint Return Test** – A taxpayer cannot claim a married person who files a joint return as a dependent, unless the married person files the return only as a claim for refund.
- **Citizenship or Resident Test** – A dependent must be a U.S. citizen, U.S. resident alien, U.S. national, or a resident of Canada or Mexico, for some part of the year.

In general, a taxpayer cannot claim a person as a dependent unless he provides more than half of the total annual support and that person is a *qualifying child* or *qualifying relative*.

- **Qualifying Child** – There are additional tests for a child to be a qualifying child:
 - 1) **Relationship Test** – The child must be a son, daughter, stepchild, foster child, brother, sister, half brother, half sister, stepbrother, stepsister, or a descendant of any of them.

- 2) Age Test – To meet this test, a child must be younger than the taxpayer and meet one of the following conditions:
 - A) Younger than age 19 at the end of the year
 - B) Younger than age 24 at the end of the year and a full-time student
 - C) Any age if permanently and totally disabled
- 3) Residency Test – Child must live with taxpayer more than half of year. A child who is born or dies during the year qualifies if the home was the child's home the entire time he was alive. A child is considered to live with a taxpayer when at the hospital following birth, or temporary absences due to special circumstances such as illness, education, business, vacation, or military service. If born alive but living for a moment (not stillborn) official documentation must prove live birth.
- 4) Support Test – The child cannot provide more than half of his own support.

Special rule for qualifying child of more than one person – If a child can be a qualifying child of more than one person, the taxpayer taking the exemption must be the person entitled to claim the child as a qualifying child. In most cases, because of the residency test, a child of divorced or separated parents is the qualifying child of the custodial parent. A noncustodial parent may claim the exemption only if the custodial parent agrees in writing (form 8332).

- **Qualifying Relative** – Unlike a qualifying child, a qualifying relative can be any age. There are four tests that must be met:

- 1) Not a qualifying child test – The child cannot be a qualifying child.
- 2) Support Test – A taxpayer generally must provide more than half of a person's total support during the year. Under a written multiple support agreement, if two or more persons together provide more than half of the support, they can agree that one will claim the exemption.
- 3) Gross Income Test – The person's gross income for the year must be less than **\$3,700**.
- 4) Member of Household or Relationship Test – To meet this test, a person must meet one of the following conditions:
 - A) Live with the taxpayer all year as a member of the household, or
 - B) Must be related in one of the following ways:
 - (a) A child, stepchild, foster child, or a descendant of any of them (for example, a grandchild). Treat a legally adopted child the same as a child.
 - (b) A brother, sister, half brother, half sister, stepbrother, or stepsister.
 - (c) A father, mother, grandparent, or other direct ancestor, but not foster parent.
 - (d) A stepfather or stepmother.
 - (e) A son or daughter of the taxpayer's brother or sister.
 - (f) A brother or sister of the taxpayer's father or mother.
 - (g) A son or daughter-in-law, father or mother-in-law, brother or sister-in-law.

Part 1 – Individuals – Chapter 1 Quiz

Circle the letter next to the best answer. Remember to read the question carefully.

- 1) Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return, will provide the taxpayer with the following:
 - a. An automatic extension of two months for taxpayers out of the country on April 15
 - b. An automatic extension of four months to pay the taxes due
 - c. An automatic extension of six months to file the return
 - d. An automatic extension of four months to file the return

- 2) Which of the following statements is true regarding the filing of a Form 4868, Application for an Automatic Extension of Time to File?
 - a. Interest is not assessed on any income tax due if a Form 4868 is filed.
 - b. Form 4868 provides the taxpayer with an automatic additional two-month extension to file.
 - c. Even though a taxpayer files Form 4868, he will owe interest and may be charged a late payment penalty on the amount owed if he does not pay the tax due by the regular due date.
 - d. A U.S. citizen, who is out of the country on April 15, will be allowed an additional 12 months to file as long as "Out of the Country" is written across the top of Form 4868.

- 3) Lisa was married with two dependent children in 2011. Her husband died in April 2011, and she did not remarry before the end of 2011. Which filing status should Lisa use for her tax return in 2011?
 - a. Single
 - b. Married Filing Jointly
 - c. Head of Household
 - d. Qualifying Widow(er) With Dependent Child

- 4) Who would not be a qualifying person for purposes of filing as Head of Household in 2011?
 - a. Your mother whom you can claim as a dependent.
 - b. Your adopted child who lives with you, is married, and can be claimed as your dependent.
 - c. Your foster child who lived with you all year and is your dependent.
 - d. Your aunt, related to you by blood. She does not live with you but is your dependent.

- 5) You do not have to pay estimated taxes if:
- Your tax liability for the previous year was less than \$1,000.
 - Your withholding covers 90% of the tax liability for the previous year.
 - Your earned income credit will exceed your tax liability for the current year.
 - All of the above.
- 6) Thomas and Rebecca are the parents of four children, ages 10, 12, 15, and 22. Their 22-year-old child is a full-time student with an income of \$5,600. Thomas and Rebecca provided more than 50% of the support for all their children. If they file a joint return, how many exemptions can they claim for the above family members?
- Five
 - Four
 - Six
 - Three
- 7) Milton is 39 years old. He is divorced from his wife since March 1 of the tax year. They have two minor children. One child lives with Milton and the other child lives with the mother. The children have been with their respective parents from March through December of the tax year. Milton provides all of the support for the minor child living with him. The filing status with the lowest rate that Milton qualifies for is:
- Married filing separately
 - Single
 - Head of household
 - Married filing jointly
- 8) John is the sole support of his mother. To claim her as a dependent on his Form 1040A for 2011, she must be a resident of which of the following countries for some part of calendar year 2011?
- United States
 - Mexico
 - Canada
 - Any of the above

Part 1 – Individuals – Chapter 1 Quiz Rationale

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- 1) **c** A request for an automatic six-month extension may be filed (via Form 4868, paper or electronically) by the due date of the return. For most taxpayers, this allows until October 15 to submit a return. The IRS will automatically allow a taxpayer who is out of the country on April 15 an extra two months to file his return and pay any tax due. Form 4868 also provides those out of the country with an additional automatic four-month extension. This is an actual question from the exam. While D is also right, the IRS considers C as the correct answer.
- 2) **c** Form 4868 is NOT an extension of time to pay taxes. Taxpayers must estimate the taxes due and submit the payment with the request. A taxpayer who is a U.S. citizen (or resident) may receive an automatic two-month extension to file a return and pay any federal income tax due if, on the due date of the return, he is in the military on duty or lives (and maintains a primary place of business) outside the United States and Puerto Rico. Interest is charged from the due date until date paid.
- 3) **b** If one spouse dies, the survivor can file jointly if he would otherwise qualify to use that status. The year of death is the last year to file jointly with a deceased spouse. In certain cases, *qualifying widow(er) with dependent child* is the filing status for two tax years following the year of death.
- 4) **d** To qualify for *head of household*, a person must be unmarried or *considered unmarried* (file a separate return and spouse did not live in home the last six months of the tax year) on the last day of the year and pay more than half the cost of keeping up a home for the year. A *qualifying person must* live with the taxpayer more than half of the year, with the exception of a mother or father. A *qualifying person* is a *qualifying child* or *qualifying relative* for whom they can claim an exemption. The aunt did not meet the residency test, even though she is a qualifying relative for purposes of the dependency exemption.
- 5) **c** U.S. citizens with no tax liability in the previous full year are not required to pay estimated tax. Estimated tax liability exists if a taxpayer will owe at least \$1,000 in tax, after subtracting withholding and credits, and withholding and credits will be less than the smaller of 90% of the tax liability, or 100% of the tax liability on prior year's return (110% if AGI is more than \$150,000).
- 6) **c** The children are dependents as they meet the definition of a qualifying child. **Relationship Test** – The child must be a son, daughter, stepchild, foster child, brother, sister, half brother, half sister, stepbrother, stepsister, or a descendant of any of them. **Age Test** – To meet this test, a child must be younger than age 19 at the end of the year, or younger than age 24 at the end of the year and a full-time student, or any age if permanently and totally disabled. **Residency Test** – The child must have lived with the taxpayer for more than half of the year. A child who was born or died during the year passes this test if the home was the child's home the entire time he or she was alive during the year. **Support Test** – The child cannot provide more than half of their own support.
- 7) **c** Since Milton is not married at the end of the year, he cannot file either MFS or MFJ. HOH is better than Single as a filing status in terms of tax rates, and all tests for HOH are met.
- 8) **d** A dependent must be a U.S. citizen, U.S. resident alien, U.S. national, or a resident of Canada or Mexico, for some part of the year.