

IRS

Tax Preparer Course

& RTRP Exam Study Guide

1040

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1040 SERIES EXAMS

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Rain Hughes, CFP® EA

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IRS Tax Preparer Course & RTRP Exam Study Guide

1040 Series Exam

The comprehensive guide to passing the IRS Registered Tax Return Preparer Examination

Rain Hughes, CFP® EA

FASTFORWARD ACADEMY



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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 and ***opportunities filter*** help you understand your weak areas.
- The ***answers report*** tracks each question, answer, and rationale that you see.

Practice Exams

How will you know when it is time to take the exam? Take a practice exam! Using our advanced testing platform, you can create simulated exams. 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) **Exam Analysis Report:** View your performance and compare yourself to the community for each section of the test. 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) **Exam Answers Report:** View completed exams and dive into specific questions, answers, and rationale.
 - 3) **Exam Time Report:** View overall time and other metrics for each exam you take. The community is also measured so you can see how your time per question compares to others taking practice 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 Tax Preparer Course and RTRP Exam Study Guide***. This course, along with our **FREE** online question bank, will provide you with everything you need to pass the IRS 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 approximately 100 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 rules within these publications may appear overwhelming, you do not need to remember them 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.

Understanding the Symbols Used in this Book



A “Key Concept” you should master. This information is very important in your review.



Practical information you might want to remember.



An example to demonstrate a point or concept.



A quick quiz question on important concepts. Answers appear in the back of the book.

Your Best Strategy to Pass

The Best Way to Use the Study Guide and the FREE Online Test Bank to Study for the Exam

- Read the study guide one chapter at a time. Take the chapter quiz at the end of each chapter. Before continuing to the next chapter, we strongly suggest using the FREE Test Bank—available at fastforwardacademy.com—which will improve your grasp of the chapter content. The FREE Test Bank allows you to filter questions by each chapter of the study guide. It is to your benefit to answer as many questions relating to each chapter as possible. Repeat this process until you are done with all chapters for the exam part you are studying.
- Review each rationale immediately after answering questions in the FREE Test Bank, rather than after answering multiple questions. This is the most effective way to promote learning. We suggest reading the rationale even if you answer a question correctly because it confirms you are on the right track and may contain additional test tips. If your first attempt is incorrect, reviewing the rationale can help you better understand the subject or concept of the question. Each rationale references a chapter of the study guide for further review. The subjects in certain “bonus” questions are either covered in multiple chapters or do not appear in the book.
- After completing all chapters, use the FREE Test Bank to answer questions on all material covered. For example, when you complete all chapters, select “All” to answer random questions from all chapters. You can also filter test questions by section to concentrate on questions that cover a particular section of the exam.

How to Use the Test Bank Filters

You can filter test questions on our FREE Test Bank three different ways—by section, chapter, or exams. The **chapter filter** works best as you read the study guide chapter by chapter as described above. You can review questions according to the official IRS categories using the **section filter**. A section may span multiple chapters, so filtering in this manner may require knowledge of several chapters in order to address all questions. We recommend completing all chapters in the study guide before filtering test bank questions by section. The **exams filter** allows you to review every practice exam you complete. In all cases, you may find it helpful to adjust the **repeat setting** as you progress through your studies. The repeat setting allows you to focus on questions answered incorrectly in previous study sessions and concentrate on strengthening your weak areas.

As you answer questions on the test bank, the **momentum meter** scores your results on a percentage basis so you can see how you measure up against the community. Use the **reports** to identify your weaker areas, and then use the test bank filter to concentrate on those areas. Once you get your momentum above 80%, you are ready to take a Practice Exam. Practice exams are a great way for you to assess your skills before you schedule your test date.

Practice Exams – The Final Level of Exam Preparation

Once you complete your studies as described, it is time to create a Practice Exam. Each Practice Exam is unique and simulates the real exam. Practice Exams are subject-weighted and timed, and they function like the real exam. Practice Exams are available at fastforwardacademy.com.

Each Practice Exam allows you to save and exit the exam. The timer stops and picks up where you left off when you re-enter the exam. Although our Practice Exams allow you to exit and re-enter, you must

complete the real exam in a single session. To best simulate the real exam, we suggest allocating enough time to complete each Practice Exam from start to finish, with no interruptions.

A practice exam can help you understand if you are ready to schedule your test. During the exam, you do not have access to the rationale for each question, so you should review any incorrect answers when you are done. You can view your **answers report** containing all questions from your exam, or you can retake the exam using the FREE Test Bank exams filter. Make sure you use the **opportunities filter** once you complete an exam to review all of your weak areas.

The available reports and the momentum meter can help you identify your weak areas. The Practice Exam momentum meter is different from that of the Free Test Bank, but the higher your momentum, the better:

- Momentum of 79% or less – Use the reports to find your weak areas. Return to the study guide and FREE Test Bank, and study your weak areas. Then, take another practice exam to measure your improvement.
- Momentum 80% or above – Use the reports and focus on the areas where you answered questions incorrectly. Use the study guide and FREE Test Bank to sharpen those areas and then take the exam!

About the IRS Registered Tax Return Preparer Exam

The RTRP Exam, also known as the IRS Registered Tax Return Preparer Competency Exam, is single exam administered by Prometric on behalf of the Internal Revenue Service. The test is on basic preparer competency. As such, the test will focus on the ethical responsibilities of federal tax return preparers and the completion of Form 1040 series along with the basic related schedules and forms. Tax preparers are required to pass this competency test in order to achieve the title of Registered Tax Return Preparer. The test will have approximately 120 questions in a combination of multiple-choice and true/false format. The time limit for the test is expected to be between two and three hours.

<u>RTPR Exam Topics</u>	<u>Percent of Exam</u>
Domain 1: Preliminary Work and Taxpayer Data	15%
Domain 2: Treatment of Income and Assets	22%
Domain 3: Deductions and Credits	22%
Domain 4: Other Taxes	11%
Domain 5: Completion of the Filing Process	10%
Domain 6: Practices and Procedures	5%
Domain 7: Ethics	15%
TOTAL	100%

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RTRP

TAX PREPARER COMPETENCY EXAM

FORM 1040 SERIES

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.

Individual Taxpayer Identification Number

An *Individual Taxpayer Identification Number (ITIN)* is a tax processing number issued by the IRS upon receipt of *Form W-7*. The IRS issues ITINs to individuals required to have a U.S. taxpayer identification number who are not eligible for a Social Security Number (SSN) from the Social Security Administration. ITINs issue regardless of immigration status because both resident and nonresident aliens may have a U.S. filing or reporting requirement under the Internal Revenue Code. Individuals must have a filing requirement and file a valid federal income tax return to receive an ITIN, unless an exception applies. Each ITIN is a nine-digit number that always begins with the number nine.

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.

Tax Payments

A non-business taxpayer with tax due on their return can pay by check, money order, or credit or debit card. Checks should be made payable to the "United States Treasury." The IRS instructs taxpayers to write identifying information on the check, including the first SSN used on the return. A payment by mail should include a **Form 1040-V Payment Voucher**, although it is not a requirement.

Installments

A taxpayer may request a monthly installment plan if he is unable to pay the full amount of tax owed. Installment agreements generally provide up to 60 months to pay the tax. In certain circumstances, the payment period could be longer or the amount agreed to could be less than the amount of tax owed. An installment plan is not valid unless accepted by the IRS. However, if a taxpayer owes \$10,000 or less and meets certain other criteria, the IRS must accept the request. Those requirements are:

- During the past five tax years, the taxpayer (and spouse if filing jointly) has timely filed all income tax returns and paid any tax due, and has not entered into an installment agreement for payment of income tax.
- The IRS determines that the taxpayer cannot pay the tax owed in full when it is due and the taxpayer gives the IRS any information needed to make that determination.
- The taxpayer agrees to pay the full amount within three years and to comply with the tax laws while the agreement is in effect.

An **installment agreement** generally requires equal monthly payments, and the taxpayer must fully pay all of the tax owed within the time left in the 10-year period during which the IRS can collect the tax. If a taxpayer cannot pay in full by the end of the collection period, but can pay some of the tax owed, he may qualify for a partial payment installment agreement. To request an installment agreement a taxpayer can attach **Form 9465** to the front of his tax return, or—in cases where the return is already filed—mail it directly to the IRS. If the IRS approves a request, they send a notice detailing the terms of the agreement and request a fee of \$105 (\$52 if payments are by electronic funds withdrawal). Lower income taxpayers may qualify to pay a reduced fee of \$43. Once approved, a taxpayer may submit a request to modify or terminate the installment agreement. This request will not suspend the statute of limitations on collection. While the IRS considers a request to modify or terminate the installment agreement, the taxpayer must comply with the existing agreement.

If a taxpayer is able to pay the full amount owed within 120 days, he should not request an installment agreement on Form 9465. Instead, he can call or apply online to establish a request to pay in full. A taxpayer who can pay within the 120-day period can avoid paying the fee to set up the agreement.

Refund Deposits

A taxpayer who is due a refund due to an overpayment of tax may apply his refund to his estimated tax liability for the following tax year, or request a repayment. The IRS can mail a check; however, the fastest way to receive a refund is through direct deposit. **Form 8888** is necessary when the taxpayer wants the refund to go into more than one account or he wants to buy up to \$5,000 in paper series I savings bonds. Otherwise, a taxpayer may enter routing and account information for his financial institution or bank directly on his tax return. The taxpayer can have his refund (or part of it) deposited directly to a traditional IRA, Roth IRA, or SEP-IRA, but not a SIMPLE IRA. He must establish the IRA at a bank or other financial institution before requesting the direct deposit. The IRS can also send a deposit to a TreasuryDirect® online account to buy U.S. Treasury marketable securities and savings bonds.

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.



The return of a taxpayer filed on 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. If a claim is filed after the 3-year period, but within two years from the time the tax is paid, the credit or refund cannot be more than the tax paid within the two years immediately before filing the claim.



You made estimated tax payments of \$1,000 and got an automatic extension of time from April 15, 2010, to October 15, 2010, to file your 2009 income tax return. When filing your return on that date, you pay an additional \$200 tax. Three years later, on October 15, 2013, you file an amended return and claim a refund of \$700. Because you filed within 3 years after filing your return, you could get a refund of any tax paid after April 15, 2010.



The situation is the same as in the prior example, except that you file your return on October 31, 2010, after the extension period ends. You paid an additional \$200 on that date. Three years later, on October 27, 2013, you file an amended return and claim a refund of \$700. Although you filed your claim within 3 years from the date you filed your original return, the refund is limited to \$200. The estimated tax of \$1,000 was paid before the 3 years plus the 6-month extension period.

A notable exception to the 3-year rule is an amended return based on a bad debt or worthless security, which a taxpayer generally must file within seven years after the due date of the return for the tax year in which the debt or security became worthless.

A taxpayer files **Form 1040X** with the same IRS Center where he filed his original return in order to claim a credit or refund for an overpayment of tax. Taxpayers use Form 1040X to do the following:

- Correct Forms 1040, 1040A, 1040EZ, 1040EZ-T, 1040NR, or 1040NR-EZ
- Make certain elections after the prescribed deadline
- Change amounts previously adjusted by the IRS
- Make a claim for a carryback due to a loss or unused credit

A taxpayer files Form 1040X only after filing the original return, and before the expiration of the deadline. The taxpayer files a separate form for each year or period involved, and includes an explanation of each item of income, deduction, or credit he uses as a basis for the claim. The taxpayer must attach all appropriate forms and schedules to Form 1040X or it will be returned. A taxpayer who files an erroneous refund claim may be subject to a penalty of 20% of the disallowance.



1.1 Joe files his 2009 income tax return on March 1, 2010. His employer withheld \$9,000 from his wages. Joe did not make any other tax payments. What is the last date Joe can file a claim for refund?

Joint and Several Liability

A married taxpayer is **jointly and severally liable** for the tax and any additions to tax, interest, or penalties that arise because of a joint return, even after divorce. Joint and several liability means that each taxpayer is legally responsible for the entire liability. One spouse may be held responsible for all the tax due, even if the other spouse earned all the income or claimed improper deductions or credits. Relief from joint liability, such as **innocent spouse relief**, is different from an **injured spouse claim**.

Injured Spouse Relief



Sometimes a liability belongs only to one spouse. A taxpayer is an “*injured spouse*” if he files a joint return and all or part of his share of the refund was, or will be, applied against the separate past-due federal tax, state tax, child support, or federal non-tax debt (such as a student loan) of his spouse with whom he filed the joint return. An injured spouse may be entitled to recoup their share of the refund.

The injured spouse files **Form 8379** with a jointly filed tax return when the joint overpayment was—or is expected to be—applied to a past-due obligation of the other spouse. By filing Form 8379, the injured spouse may be able to get back his or her share of the joint refund. The taxpayer may file form 8379 with a joint return, with an amended return, or by itself at a later time.



Tom and Lucy expect a refund of \$5,000 when they jointly file their tax return. Tom has \$60,000 in past-due taxes that he accumulated prior to getting married. To prevent the entire refund from being applied against his past-due obligation, they can file Form 8379, to protect Lucy's share of the refund.

Extensions

A taxpayer may request an **automatic six-month extension** by filing Form 4868 (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. The taxpayer must estimate the taxes due and can submit the payment with the extension 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**. A taxpayer using this method reports interest income in the year of **constructive receipt**. Constructive receipt occurs when the income is available for the 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.



Jill is a cash basis taxpayer. To earn extra money she works as a photographer in the month of December. Jill shot a family portrait for the Johnson family on December 15, 2010 and received a check for her work on that date. The Johnsons dated the check January 2, 2011 and asked Jill not to cash it until that time. Jill does not recognize this income in 2010 because of the restriction on withdrawal.

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. Income is earned when all the events have occurred that fix the right to receive it and the amount can be determined with reasonable accuracy.



Using the same facts as previous example, in what year would Jill recognize income from her photo shoot if she uses the accrual method to account for income and expenses?

Filing Requirements

Individuals

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

Table 1-1. 2010 Filing Requirements for Most Taxpayers

IF filing status is...	AND at the end of 2010, the taxpayer was ...	THEN file a return if the gross income was at least ...
Single	younger than 65	\$9,350
	65 or older	\$10,750
Married Filing Jointly	younger than 65 (both spouses)	\$18,700
	65 or older (one spouse)	\$19,800
	65 or older (both spouses)	\$20,900
Married Filing Separately	any age	\$3,650
Head of Household	younger than 65	\$12,050
	65 or older	\$13,450
Qualifying Widow(er) with Dependent Child	younger than 65	\$15,050
	65 or older	\$16,150

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. 2010 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 \$5,700. • Your gross income was more than the larger of: <ul style="list-style-type: none"> - \$950, or - Your earned income (up to \$5,400) 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 \$2,350 (\$3,750 if 65 or older and blind). • Your earned income was more than \$7,100 (\$8,500 if 65 or older and blind). • Your gross income was more than the larger of: <ul style="list-style-type: none"> - \$2,350 (\$3,750 if 65 or older and blind), or - Your earned income (up to \$5,400) plus \$1,700 (\$3,100 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

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 1040NR) if additional taxes are due or if conducting a business in the United States. 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.

Form 1040 and Schedules

A citizen or resident of the United States who is required to file a tax return will use Form 1040 to report information to the IRS. There are three variations: Form 1040EZ, Form 1040A, or Form 1040.

- **Form 1040EZ** – Form 1040EZ is the simplest form to use. The taxpayer must use the tax table to figure tax due, and cannot use Form 1040EZ to report any other tax.
- **Form 1040A** – Those who do not qualify to use Form 1040EZ may be able to use Form 1040A.
- **Form 1040** – All other taxpayers must use Form 1040.

Form 1040EZ

As the name suggests, Form 1040EZ is the easiest to file, but it does not apply to all situations. Only single and joint filers with no dependents are able to use Form 1040EZ. It is a tax return in its most basic form. A taxpayer does not attach any additional schedules to form 1040EZ. In order to file with form 1040EZ the taxpayer must meet all of the following conditions:

- Taxable income must be less than \$100,000
- Cannot claim any dependents

- Filing status must be single or married filing jointly. If the taxpayer was a nonresident alien at any time in 2010, their filing status must be married filing jointly
- The taxpayer (and their spouse if married filing a joint return) must be under age 65 and not blind at the end of 2010
- Income is only from wages, salaries, tips, unemployment compensation, Alaska Permanent Fund dividends, taxable scholarship and fellowship grants, and taxable interest of \$1,500 or less
- Cannot receive any advance earned income credit (EIC) payments
- The taxpayer cannot claim any adjustments to income, such as a deduction for IRA contributions or student loan interest
- No credits allowed other than the *earned income credit* or the *making work pay credit*
- The taxpayer cannot owe household employment taxes on wages for a household employee
- Cannot claim the additional standard deduction



Form 1040-EZ is useful only for taxpayers with simple returns. Of the three choices, Form 1040-EZ is the most limited in scope. A taxpayer who can benefit from the Head of Household filing status or claiming dependents should use Form 1040 or Form 1040A.

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Form 1040A

A taxpayer of any age or filing status may use Form 1040A. Even if a taxpayer can use Form 1040EZ, using Form 1040A may be beneficial. A common reason to file Form 1040A is to claim the head of household filing status, which usually results in a lower tax than filing with a status of single. While form 1040A applies to a greater number of taxpayers, it is not available to all taxpayers. A taxpayer using Form 1040A must meet all the following conditions:

- Taxable income must be less than \$100,000
- In addition to the income available for a 1040EZ filer, those using form 1040A may also have income from the following sources: IRA distributions, pensions and annuities, interest, ordinary dividends, capital gain distributions (but not unrecaptured section 1250 gain, section 1202 gain, or collectibles gain), taxable social security and railroad retirement benefits
- Adjustments to income cannot be for anything other than the following items:
 - 1) IRA deduction
 - 2) Student loan interest deduction
 - 3) Educator expenses
 - 4) Tuition and fees deduction
- The taxpayer cannot itemize deductions

- Taxes can only come from the following items:
 - 1) Tax Table
 - 2) Alternative minimum tax
 - 3) Advance earned income credit (EIC) payments
 - 4) Recapture of an education credit
 - 5) Form 8615, Tax for Certain Children Who Have Investment Income of More Than \$1,900
 - 6) Qualified Dividends and Capital Gain Tax Worksheet
- The taxpayer can only claim the following tax credits:
 - 1) The credit for child and dependent care expenses
 - 2) The credit for the elderly or the disabled
 - 3) The child tax credit
 - 4) The additional child tax credit
 - 5) The education credits
 - 6) The retirement savings contributions credit
 - 7) The earned income credit
 - 8) The making work pay credit
- The taxpayer cannot have an alternative minimum tax adjustment on stock acquired from the exercise of an incentive stock option



Form 1040A is more flexible than 1040EZ with respect to sources of income, deductions, credits, and tax; however, it is not without limits. Substantial limitations of Form 1040A include the lack of ability to itemize deductions or report business income. As a result, taxpayers most often use Form 1040.

Form 1040

A taxpayer who cannot use Form 1040EZ or Form 1040A must use Form 1040 to report all types of income, deductions, and credits. The tax calculation is no different from one form to another; however, it is possible that a taxpayer may pay less tax by filing Form 1040 because of the ability to claim itemized deductions, additional adjustments to income, and credits not available on Form 1040A or Form 1040EZ. A taxpayer must use form 1040 if any of the following apply:

- Taxable income is \$100,000 or more
- The taxpayer will itemize deductions
- The taxpayer has income that cannot be reported on Form 1040EZ or Form 1040A, including tax-exempt interest from private activity bonds issued after August 7, 1986.
- The taxpayer claims any credits or adjustments to gross income not allowed on Form 1040A.

- The taxpayer has Form W-2 that shows either of the following:
 - 1) Uncollected employee tax (social security and Medicare tax) on tips or group-term life insurance
 - 2) Income from Nonqualified deferred compensation plans (box 12 with a code Z)
- The taxpayer received \$20 or more in unreported tips in any 1 month
- The taxpayer was a bona fide resident of Puerto Rico and excludes income from Puerto Rico sources
- The taxpayer owes excise tax on insider stock compensation from an expatriated corporation
- The taxpayer has a qualified health savings account funding distribution from their IRA
- The taxpayer is an employee and their employer did not withhold social security and Medicare tax
- It is necessary to file other forms with the return to report certain exclusions, taxes, or transactions
- The taxpayer is a debtor in a bankruptcy case filed after October 16, 2005
- The taxpayer has a net disaster loss attributable to a federally declared disaster
- The taxpayer must recapture the first-time homebuyer credit
- The taxpayer received a refund or credit of certain taxes or net disaster loss claimed as part of their standard deduction

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1.3 Ramona is 70 years old and receives \$20,000 in social security benefits. Taxes are not withheld from the payments. She has no other income or deductions. What is the easiest form she is required to file?

Form 1040 Schedules

A taxpayer may file certain schedules along with Form 1040, and in certain cases Form 1040A. Assemble any schedules and forms behind Form 1040 (or 1040A) in order of the "Attachment Sequence No." shown in the upper right corner of the schedule or form. A taxpayer filing with Form 1040 or 1040A can attach the following schedules to their return:

- **Schedule B, Interest and Ordinary Dividends** – A taxpayer completes this schedule if any of the following conditions apply:
 - 1) The taxpayer has over \$1,500 of taxable interest or ordinary dividends
 - 2) Receipt of interest from a seller-financed mortgage and the buyer used the property as a personal residence
 - 3) He has accrued interest from a bond
 - 4) He reports original issue discount (OID) less than the amount shown on Form 1099-OID
 - 5) He reduces interest income on a bond by the amount of amortizable bond premium
 - 6) He claims an exclusion of interest from series EE or I U.S. savings bonds issued after 1989
 - 7) He receives interest or ordinary dividends as a nominee
 - 8) He has certain interest in a financial account in a foreign country or a foreign trust

- **Schedule EIC, Earned Income Credit** – A taxpayer with one or more qualifying children can file this schedule to claim the earned income credit.
- **Schedule L, Standard Deduction for Certain Filers** – Use Schedule L to figure the 2010 increased standard deduction for taxpayers in the following circumstances:
 - 1) The taxpayer has a loss from a disaster that was declared a federal disaster in tax years beginning after 2007 and that occurred before 2010
 - 2) The taxpayer paid state or local sales or excise taxes (or certain other taxes or fees in a state without a sales tax) in 2010 for the purchase of any new motor vehicle(s) after February 16, 2009, and before January 1, 2010.
- **Schedule M, Making Work Pay Credit** – A taxpayer filing a 2010 return can use this schedule to claim a credit equal to the smaller of \$400 (\$800 MFJ) or 6.2% of earned income. Subtract any recovery rebate credit received in 2010 from the credit amount. The credit declines by 2% of income in excess of \$75,000 (\$150,000 MFJ). The credit expires after 2010.
- **Schedule R, Credit for the Elderly or the Disabled** – A U.S. citizen or resident alien with limited income who is age 65 or older at the end of the year can file this schedule to receive a credit.

The following schedules are only available when using Form 1040 to file a tax return:

- **Schedule A, Itemized Deductions** – When itemized deductions exceed the amount of the standard deduction, a taxpayer attaches Schedule A to Form 1040 in order to claim the higher amount.
- **Schedule C, Net Profit or Loss from Business** – A “self-employed” taxpayer files Schedule C with Form 1040 to report income and deductions resulting from their trade or business. To file this schedule the taxpayer must operate a business as one of the following:
 - 1) Sole proprietor or disregarded entity (single member LLC treated as a sole proprietor)
 - 2) Qualified joint venture
 - 3) Statutory employee
- **Schedule C-EZ, Net Profit from Business** – This is really just a simplified version of Schedule C. It is available if a taxpayer has a small business that does not have a loss. Other requirements for a taxpayer using this schedule include:
 - 1) Business expenses of \$5,000 or less
 - 2) Must use the cash method of accounting
 - 3) Cannot have an inventory at any time during the year
 - 4) Must have only one business as a sole proprietor, qualified joint venture, or statutory employee
 - 5) Cannot have employees
 - 6) Cannot deduct expenses for business use of home
 - 7) Cannot have prior year disallowed passive activity losses from the business
 - 8) Cannot be required to file form 4562, Depreciation and Amortization for the business

- **Schedule D, Capital Gains and Losses** – A taxpayer uses Schedule D to report the sale or exchange of capital assets. Most property held for personal purposes, pleasure, or investment is a capital asset. The transactions reportable on this schedule include the following:
 - 1) Sales, exchanges, or involuntary conversions of capital assets
 - 2) Capital gain distributions not reported directly on Form 1040
 - 3) Nonbusiness bad debts
- **Schedule D-1, Continuation Sheet for Schedule D** – A taxpayer uses this schedule only if there are too many transactions to fit on Schedule D.
- **Schedule E, Supplemental Income and Loss** – A taxpayer attaches Schedule E to report income or loss from rental real estate, royalties, partnerships, S corporations, estates, trusts, and residual interests in REMICs.
- **Schedule F, Profit or Loss From Farming** – Farmers use Schedule F to figure net profit or loss from regular farming operations. This includes farm products raised for sale or products bought for resale.
- **Schedule J, Income Averaging for Farmers and Fishermen** – Use Schedule J to elect to figure income tax by averaging, over the previous 3 years (base years), all or part of current year taxable income from farming or fishing. This election does not apply when figuring alternative minimum tax.
- **Schedule SE, Self-Employment Tax** – Withholding tax for social security or Medicare does not apply to net earnings from self-employment. A self-employed taxpayer uses Schedule SE to figure the tax due on net earnings from self-employment. The taxpayer uses **Schedule SE** and calculates self-employment tax, which is essentially social security and Medicare tax for the self-employed. A taxpayer must include their share of certain partnership income and guaranteed payments as income from self-employment. In 2010, a tax rate of 15.3% applies to the first \$106,800 of income from self-employment. A tax rate of 2.9% applies to the excess. Schedule SE is required under either of the following circumstances:
 - 1) Net earnings from self-employment of \$400 or more
 - 2) Wages are \$108.28 or more from a church or qualified church-controlled organization that is exempt from employer Social Security and Medicare taxes. Income from services performed as a minister or a member of a religious order is not church employee income.



1.4 Jasmine has taxable income of \$150,000 in 2010. She is single, has no dependents, and claims the standard deduction. Which tax form(s) can she use to report her income for tax year 2010?

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. In order to determine the proper amount of withholding, an employee completes **Form W-4, Employee’s Withholding Allowance Certificate** indicating the number of personal allowances and

provides the form to the employer. A taxpayer may indicate an additional amount of tax to withhold from their pay. An exemption from withholding is possible by writing the word “EXEMPT” on line 7, if the taxpayer can meet both of the following conditions for exemption:

- Last year they had no tax liability, and a right to a refund of all federal income tax withheld, and
- This year they expect a refund of all federal income tax withheld because they expect no tax liability

Individuals may withhold tax on income sources like pensions, bonuses, commissions, and gambling winnings. Recipients of pensions, annuities (including commercial annuities), and certain other deferred compensation will use **Form W-4P, Withholding Certificate for Pension or Annuity Payments** to tell payers the correct amount of federal income tax to withhold, to choose not to have any federal income tax withheld, or to have an additional amount of tax withheld. Like Form W-4, a taxpayer indicates the proper number of personal allowances on the form. The taxpayer can check a box and elect not to withhold. The withholding agent does not send these forms to the IRS unless there is a written request.

A taxpayer who receives certain government payments may elect voluntary withholding of federal income tax using **Form W-4V, Voluntary Withholding Request**. The following payments are eligible:

- Unemployment compensation (including Railroad Unemployment Insurance Act (RUIA) payments)
- Social security benefits
- Social security equivalent Tier 1 railroad retirement benefits
- Commodity Credit Corporation loans
- Certain crop disaster payments under the Agricultural Act of 1949 or the Disaster Assistance Act

For unemployment compensation, the payer is permitted to withhold 10% from each payment. No other percentage or amount is allowed. For any other government payment listed above, the taxpayer may choose to have the payer withhold federal income tax of 7%, 10%, 15%, or 25% from each payment.

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 must make estimated quarterly payments.



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)



Jason earns \$130,000, and his tax liability for the current year is \$10,000, double what it was the prior year. He can avoid a penalty if his combined payments are at least \$4,500 (90% of prior year liability).

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 in the following table (next business day if on holiday). Non-business taxpayers use Form 1040-ES to make estimated payments to the IRS.

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)



Margaret sold an investment property in July. She has no other income and did not owe taxes the prior year. She estimates owing \$25,000 in taxes because of the transaction. If she is required to pay estimated tax, she must make her first payment by September 15. However, she had no tax liability in the prior year, and is not required to make estimated payments.

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 related to the taxpayer (not merely a member of the household). 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.



1.5 Jane and her husband Greg are eligible to file a joint return. Greg died on January 2, 2010, and Jane did not remarry. She has a 10-year old son. Can she file jointly with her deceased husband in 2010?

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 dies. This filing status entitles the surviving spouse 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 dies
- 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 must live 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



Jane files a joint return the year her husband dies (2010). If her son meets the requirements discussed above, she can choose Qualifying Widow with Dependent Child as her status for 2011 and 2012.

Personal Exemptions and Dependents

There are two types of exemptions: *personal exemptions* and *exemptions for dependents*. While each is worth the same amount (**\$3,650 for 2010**), different rules apply. In 2010, 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. The custodial parent is generally the parent with whom the child lived for the greater number of nights during the year. A noncustodial parent may claim the exemption only if the custodial parent agrees in writing (Form 8332). The release of claim may be for the current year, and/or future years. The noncustodial parent must attach Form 8332 or similar acceptable statement to their tax return for each year they claim the exemption for the child.

- **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. The person claiming the dependency exemption must provide at least 10% of the total support for the qualifying individual, and no other person can pay over half of the total support. Each eligible person who pays over 10% of support must provide the taxpayer with a signed statement agreeing not to claim the qualifying individual as a dependent. The taxpayer will file *Form 2120, Multiple Support Declaration* with their tax return attesting to the agreement.
 - 3) Gross Income Test – The person’s gross income for the year must be less than **\$3,650**.
 - 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
 - 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.



A qualifying relative must be related in one of the ways listed above, or live with the taxpayer all year as a member of the household. If the relationship does not violate local law, any person meeting the tests above can be a “qualifying relative,” even if not a blood relative. A qualifying relative by virtue of family lineage need not live with the taxpayer.

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Tax Return Preparer Competency Exam – 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 2010. Her husband died in April 2010, and she did not remarry before the end of 2010. Which filing status should Lisa use for her tax return in 2010?
 - 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 2010?
 - 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 2010, she must be a resident of which of the following countries for some part of calendar year 2010?
- United States
 - Mexico
 - Canada
 - Any of the above

Tax Return Preparer Competency Exam – 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 live with the taxpayer for more than half of the year. A child who is born or dies 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.

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