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Pearson's Fed. Taxation 2025: Corp., 38e (Richardson et al.)
Chapter C1: Tax Research

LO1: Overview of Tax Research

1) Tax planning is not an integral part of open-fact situations.
Answer: FALSE
Explanation: It is integral.
Page Ref.: C:1-2
Objective: 1

2) When a taxpayer contacts a tax advisor requesting advice as to the most advantageous way to dispose of a stock, the tax advisor is faced with
A) a restricted-fact situation.
B) a closed-fact situation.
C) an open-fact situation.
D) a recognized-fact situation.
Answer: C
Explanation: Advice before transaction is open fact situation.
Page Ref.: C:1-2
Objective: 1

3) Investigation of a tax problem that involves a closed-fact situation means that
A) the client's transactions have already occurred and the tax questions must now be resolved.
B) the client's tax return has yet to be filed.
C) future events may be planned and controlled.
D) research is primarily concerned with applying the law to the facts as they exist.
Answer: A
Explanation: After the fact request is a closed fact situation.
Page Ref.: C:1-2
Objective: 1

4) Explain the difference between a closed-fact and open-fact situation.
Answer: In a closed-fact situation, the transaction has occurred and the facts are not subject to change. In an open-fact situation, the transaction is in the formative or projected stage, and the taxpayer is able to structure the facts so that the tax consequences of the transaction can be more favorable.
Page Ref.: C:1-2
Objective: 1

5) In all situations, tax considerations are of primary importance. Do you agree or disagree? Support your answer.
Answer: It is important to consider nontax objectives as well as tax objectives. For instance, if a wealthy client wants to minimize her estate taxes while passing the greatest value possible to her descendants, you would not suggest that she leave the majority of her estate to charity and only a few hundred thousand dollars to her descendants. Although this would reduce her estate tax liability to zero, it would be inconsistent with her objective of allowing her descendants to receive as much after-tax wealth as possible.
Page Ref.: C:1-3
Objective: 1

LO2: Steps in the Tax Research Process

1) Identify which of the following statements is true.
A) Tax planning is an integral part of both closed-fact situations and open-fact situations.
B) The first step in conducting tax research is to clearly understand the issues involved.
C) The Statements on Standards for Tax Services recommend that only written tax advice be provided to the client in all situations.
D) All of the above are false.
Answer: C
Explanation: The Statements on Standards for Tax Services recommend that only written tax advice be provided to the client in all situations.
Page Ref.: C:1-3 through C:1-5
Objective: 2

2) Describe the format of a client memo.
Answer: A client memo should include a statement of the facts, a list of issues, a discussion of relevant authority, analysis, and recommendations of appropriate actions to the client based on the research results.
Page Ref.: See Additional Comment page C:1-4
Objective: 2

3) Outline and discuss the tax research process.
Answer:
1) The facts must be determined. However, some facts may not have occurred in an open-fact situation. Where facts have not yet occurred, it is useful to review tax research material to determine which facts would produce the most favorable outcome.
2) The issues must be determined. The issues may not always be clear and may be different than the client believes. Thus, only a thorough understanding of the facts permits an adequate formulation of the issues.
3) Determine which authorities are applicable.
4) Evaluate the authorities. Choose the ones to follow when there are conflicting authorities.
5) Communicate the result to the client. The communication with the client should not result in a misunderstanding. While discussions with the client may be suitable, it is recommended by the AICPA's Statements on Standards for Tax Services that the communication be written where issues are important, unusual or complicated. Many firms require that conclusions be communicated in writing.
Page Ref.: C:1-4
Objective: 2

4) A client approaches you regarding the tax implications of an acquisition of a competitor's business. Describe the six basic steps of tax research process to assist the client.
Answer: In both open- and closed-fact situations, the tax research process involves six basic steps:
1. Determine the facts.
2. Identify the issues (questions).
3. Locate the applicable authorities.
4. Evaluate the authorities and choose those to follow where the authorities conflict.
5. Analyze the facts in terms of the applicable authorities.
6. Communicate conclusions and recommendations to the client.
Page Ref.: C:1-3
Objective: 2

5) When should oral client communications be followed up in writing?
Answer: Written communications are recommended in important, unusual, substantial dollar value, or complicated transactions.
Page Ref.: C:1-5
Objective: 2

6) Explain the difference between tax compliance versus tax consulting.
Answer: Tax compliance is assisting taxpayers in preparing and filing necessary tax forms and often includes responding to communications from tax authorities. Tax consulting is research and analysis, often referred to as tax planning, that addresses various scenarios to determine the best tax outcome given the law and the underlying facts in the case. Tax consulting will vary depending if the facts are closed or open. Closed facts generally involve tax compliance. Open facts allow for the flexibility to structure transactions for the best possible outcome.
Page Ref.: C:1-5
Objective: 2

LO3: Importance of the Facts to the Tax Consequences

1) The tax consultant can give an opinion on a tax fact pattern without all the facts.
Answer: FALSE
Explanation: Tax practitioner should not provide an opinion without all relevant facts.
Page Ref.: C:1-6
Objective: 3

2) Tax compliance is the biggest component of a tax practice.
Answer: FALSE
Explanation: Tax consulting is the biggest component of tax practice.
Page Ref.: C:1-6
Objective: 3

LO4: The Sources of Tax Law

1) The Internal Revenue Code of 1986 contains the current version of the tax law.
Answer: TRUE
Explanation: The last update was 1986.
Page Ref.: C:1-8
Objective: 4

2) Regulations issued prior to the latest tax legislation dealing with a specific Code section are still effective to the extent they do not conflict with the provisions in the new legislation.
Answer: TRUE
Explanation: Per IRC this remains accurate.
Page Ref.: C:1-9
Objective: 4

3) Final regulations have almost the same legislative weight as the IRC.
Answer: TRUE
Explanation: The Courts have followed this concept.
Page Ref.: C:1-10
Objective: 4

4) A revenue ruling is issued by the Internal Revenue Service only in response to a verbal inquiry by a taxpayer.
Answer: FALSE
Explanation: The IRS may voluntarily issue a revenue ruling.
Page Ref.: C:1-12
Objective: 4

5) Taxpayers must pay the disputed tax prior to filing a case with the Tax Court.
Answer: FALSE
Explanation: Tax Court is the only court available in which taxpayer does not have to prepay the tax.
Page Ref.: C:1-14 and C:1-15
Objective: 4

6) Appeals from the U.S. Tax Court are to the Court of Appeals for the Federal Circuit.
Answer: FALSE
Explanation: Appeals from the US Tax Court are to the Court of Appeals for the respective circuit.
Page Ref.: C:1-14 and C:1-15
Objective: 4

7) Appeals from the Court of Appeals go to the Supreme Court under a writ of certiorari. The Supreme Court decides whether or not they will hear the case.
Answer: TRUE
Explanation: USSC reviews requests before acceptance.
Page Ref.: C:1-14 and C:1-15
Objective: 4

8) When the Tax Court follows the opinion of the circuit court of appeals to which the case is appealable, the court is following the
A) Golsen rule.
B) Acquiescence rule.
C) Forum shopping rule.
D) Conformity rule.
Answer: A
Explanation: Since 1970 the Tax Court has followed the Golsen rule.
Page Ref.: C:1-21
Objective: 4

9) Which of the following citations denotes a regular decision of the Tax Court?
A) 41 TCM 1272
B) 35 T.C. 1083 (2003)
C) 39 AFTR 2d 77-640
D) 41 USSC 1099
Answer: B
Explanation: TC is Tax Court citation.
Page Ref.: C:1-17
Objective: 4

10) The primary citation for a federal circuit court of appeals case would be
A) 40 AFTR 2d 78-1234.
B) 44 F.Supp. 403.
C) 3 F.3d 134.
D) 79-2 USTC & 9693.
Answer: C
Explanation: Citation for federal circuit.
Page Ref.: C:1-20
Objective: 4

11) You have the following citation: Joel Munro, 92 T.C. 71 (1989). Which of the following statements is true?
A) The taxpayer, Joel Munro, won the case because there is no reference to the IRS.
B) The case appears on page 71 in Volume 92 of the official Tax Court of the United States Reports and the case was decided in 1989.
C) This citation refers to a taxpayer conference between the IRS and the taxpayer.
D) The case was tried in 1989 and was appealed in 1992.
Answer: B
Explanation: Citation locator is correct.
Page Ref.: C:1-17
Objective: 4

12) The term "tax law" includes
A) Ways and Means Committee Report.
B) IRS Instructions.
C) third-party tax advice websites.
D) legislation, treasury regulations & judicial decisions.
Answer: D
Explanation: Each of these have value of tax law.
Page Ref.: C:1-7
Objective: 4

13) Identify which of the following statements is false.
A) When tax advisors speak of the "tax law," they usually have in mind just the Internal Revenue Code.
B) Members from both the House and the Senate are on the Conference Committee.
C) Records of committee hearings are helpful in determining Congressional intent.
D) All of the above are false.
Answer: A
Explanation: IRC is the main source document.
Page Ref.: C:1-7
Objective: 4

14) The committee that is responsible for holding hearings on tax legislation for the House of Representatives is the
A) Finance Committee.
B) Joint Committee on Taxation.
C) Conference Committee.
D) Ways and Means Committee.
Answer: D
Explanation: The Ways and Means is responsible for holding hearings on tax legislation.
Page Ref.: C:1-7
Objective: 4

15) A tax bill introduced in the House of Representatives is then
A) referred to the House Ways and Means Committee for hearings and approval.
B) referred to the entire House for hearings.
C) voted upon by the entire House.
D) forwarded to the Senate Finance Committee for consideration.
Answer: A
Explanation: Tax bills are referred to the Ways and Means Committee.
Page Ref.: C:1-7
Objective: 4

16) The Senate equivalent of the House Ways and Means Committee is the Senate
A) Finance Committee.
B) Ways and Means Committee.
C) Tax Committee.
D) Joint Conference Committee.
Answer: A
Explanation: Senate committee is Finance Committee.
Page Ref.: C:1-7
Objective: 4

17) Which of the following steps, related to a tax bill, occurs first?
A) signature or veto by the President of the United States
B) consideration by the Senate Finance Committee
C) consideration by the entire Senate
D) consideration by the House Ways and Means Committee
Answer: D
Explanation: Tax bill is considered by House Ways and Means Committee.
Page Ref.: C:1-7
Objective: 4

18) When the House and Senate versions of a tax bill are not in agreement, the disagreements are resolved by the
A) Ways and Means Committee.
B) Mediation Committee.
C) Revenue Committee.
D) Conference Committee.
Answer: D
Explanation: Conference committee resolves disagreements.
Page Ref.: C:1-7
Objective: 4

19) Identify which of the following statements is true.
A) Paragraph references are most commonly used when citing or referring to the tax statutes.
B) Title 26 of the United States Code and the Internal Revenue Code of 1986 are synonymous.
C) Before 1939, tax statutes were codified or compiled into one document.
D) The Internal Revenue Code contains chapters, which are further subdivided into titles.
Answer: B
Explanation: IRC is Title 26 of the USC.
Page Ref.: C:1-8
Objective: 4

20) Title 26 of the U.S. Code includes
A) income tax legislation only.
B) gift tax and estate tax legislation only.
C) alcohol and tobacco tax legislation only.
D) all of the tax legislation mentioned above.
Answer: D
Explanation: Title 26 covers tax legislation.
Page Ref.: C:1-8
Objective: 4

21) The tax statutes with the popular name "The Internal Revenue Code of 1986" are contained in which Title of the Code?
A) 20
B) 25
C) 26
D) 301
Answer: C
Explanation: Title 26 covers tax legislation.
Page Ref.: C:1-8
Objective: 4

22) Which of the following statements regarding proposed regulations is not correct?
A) Proposed regulations expire after three years.
B) Practitioners and other interested parties may comment on proposed regulations.
C) Proposed and temporary regulations are generally issued simultaneously.
D) Proposed regulations do not provide any insight into the IRS's interpretation of the tax law.
Answer: D
Explanation: Proposed regulations provide insight into the IRS's interpretation of the tax law.
Page Ref.: C:1-9
Objective: 4

23) Final regulations can take effect on any of the following dates except
A) the effective date of the statutory language they interpret, provided they are issued within 18 months of the date of the change to the statute.
B) the date on which final regulations were proposed.
C) the date on which related temporary regulations were first published in the Federal Register.
D) the date on which they were issued in final form.
Answer: A
Explanation: Once finalized, regulations can be effective the earliest of (1) the date they were filed with the *Federal Register*, a daily publication that contains federal government pronouncements; (2) the date temporary regulations preceding them were first published in the *Federal Register*; or (3) the date on which a notice describing the expected contents of the regulation was issued to the public. For changes to the IRC enacted after July 29, 1996, the Treasury Department generally cannot issue regulations with retroactive effect.
Page Ref.: C:1-10
Objective: 4

24) When Congress passes a statute with language such as, "The Secretary shall prescribe such regulations as he may deem necessary," the regulations ultimately issued for that statute are
A) congressional regulations.
B) statutory regulations.
C) interpretative regulations.
D) legislative regulations.
Answer: D
Explanation: Whenever the IRC contains language such as "The Secretary shall prescribe such regulations as he may deem necessary" or "under regulations prescribed by the Secretary," the regulations interpreting the IRC provision are legislative.
Page Ref.: C:1-10
Objective: 4

25) Regulations are
A) equal in authority to legislation.
B) equal in authority to legislation if statutory.
C) presumed to be valid and to have almost the same weight as the IRC.
D) equal in authority to legislation if interpretative.
Answer: C
Explanation: Final Treasury Regulations are presumed to be valid and have almost the same authoritative weight as the IRC.
Page Ref.: C:1-10
Objective: 4

26) Identify which of the following statements is true.
A) If regulations are issued prior to the latest tax legislation dealing with a specific Code section, the regulations are no longer effective to the extent they conflict with the provisions in the new legislation.
B) Legislative regulations are more likely to be invalidated by the courts than are interpretative regulations.
C) Regulations have more authoritative weight than tax statutes.
D) All of the above are false.
Answer: A
Explanation: Because of frequent IRC changes, the Treasury Department does not always update the regulations in a timely manner. Consequently, when consulting a regulation, a tax advisor should check its introductory or end note to determine when the regulation was adopted. If the regulation was adopted before the most recent revision of the applicable IRC section, the regulation should be treated as authoritative to the extent consistent with the revision. Thus, for example, if a regulation issued before the passage of an IRC amendment specifies a dollar amount, and the amendment changed the dollar amount, the regulation should be regarded as authoritative in all respects except for the dollar amount.
Page Ref.: C:1-9
Objective: 4

27) Identify which of the following statements is false.
A) The number "5" in the citation Reg. Sec. 1.166-5 refers to the paragraph number.
B) The Cumulative Bulletin is issued semiannually while the Internal Revenue Bulletin is issued weekly.
C) The citation Rev. Rul. 2006-5, I.R.B. 2006-1, 33, indicates that the revenue ruling can be found on page 33 of the 1st I.R.B. for 2006.
D) All of the above are false.
Answer: A
Explanation: #5 references the fifth regulation of IRC 166.
Page Ref.: C:1-11
Objective: 4

28) The number appearing immediately following the decimal place in a regulation citation refers to the
A) general subject matter of the regulation.
B) Code section being interpreted.
C) sequential number of the regulation.
D) subsection of the Code section being interpreted.
Answer: B
Explanation: The number appearing after decimal refers to code section.
Page Ref.: C:1-11
Objective: 4

29) The citation "Reg. Sec. 1.199-2" refers to
A) the first regulation issued in 1999.
B) the second regulation issued in 1999.
C) a regulation that interprets Code Section 199.
D) a regulation that can be found on page 199.
Answer: C
Explanation: Number appearing after decimal refers to code section.
Page Ref.: C:1-11
Objective: 4

30) Which regulation deals with Code Section 165?
A) Reg. Sec. 1.165-5
B) Reg. Sec. 165.183-5
C) Reg. Sec. 1.5-165
D) Reg. Sec. 165-5
Answer: A
Explanation: Number appearing after decimal refers to code section.
Page Ref.: C:1-11
Objective: 4

31) Which regulation deals with the gift tax?
A) Reg. Sec. 1.165-5
B) Reg. Sec. 20.2014-5
C) Reg. Sec. 25.2518-5
D) Reg. Sec. 301.7002-5
Answer: C
Explanation: Code section 2518 is a gift tax matter.
Page Ref.: C:1-11
Objective: 4

32) Which of the following best describes the weight of a revenue ruling?
A) Revenue rulings carry more weight than regulations.
B) Revenue rulings carry more weight than federal court decisions.
C) Regulations carry more weight than revenue rulings.
D) Revenue rulings should never be used as authority since they only apply to the taxpayer requesting the ruling.
Answer: C
Explanation: Regulations carry more weight than revenue rulings.
Page Ref.: C:1-12
Objective: 4

33) The citation "Rev. Rul. 2006-8, 2006-1 C.B. 541" refers to
A) the eighth ruling of 2006 found on page 541 in Vol. 1 of the 2006 Cumulative Bulletin.
B) the eighth ruling of 2006 found on page 541 in the 2006 volume of the Cumulative Bulletin.
C) the 541st ruling of 2006 found on page eight in Vol. 1 of the 2006 Cumulative Bulletin.
D) the 1st ruling of 2006 found on page 541 in the 2006 volume of the Cumulative Bulletin.
Answer: A
Explanation: This is the 8th ruling of 2006, it appears on page 541 of Volume 1 of the 2006 Cumulative Bulletin
Page Ref.: C:1-12
Objective: 4

34) Which of the following documents is issued by the IRS to a specific taxpayer?
A) regulation
B) revenue procedure
C) letter ruling
D) information release
Answer: C
Explanation: Letter rulings are addressed to specific taxpayer.
Page Ref.: C:1-12
Objective: 4

35) Identify which of the following statements is <u>false</u>.
A) A revenue ruling is issued by the Internal Revenue Service only in response to a written inquiry by a taxpayer.
B) Rev. Proc. 2006-19 is a revenue procedure that was published in 2006.
C) The citation Ltr. Rul. 200611075 usually indicates the ruling was made public in the 11th week of 2006.
D) A technical advice memorandum is made available as a letter ruling.
Answer: A
Explanation: Letter rulings are only issued in response to written taxpayer request.
Page Ref.: C:1-11 through C:1-13
Objective: 4

36) Identify which of the following statements is <u>false</u>.
A) Letter rulings are not published by the U.S. Government Printing Office.
B) Technical advice memoranda are issued by the Internal Revenue Service's National Office to provide an answer to a technical question that arises in an audit.
C) The citation Ann. 2006-12, I.R.B. 2006-51, 22 refers to an annotation of an Internal Revenue Service release.
D) Announcements are more technical than information releases.
Answer: C
Explanation: Citation references Announcement not Annotation.
Page Ref.: C:1-13
Objective: 4

37) A Technical Advice Memorandum is usually
A) an internal IRS document describing alternative legislative proposals.
B) part of a Tax Court decision.
C) requested by the taxpayer before entering into a taxable transaction.
D) issued by the national office in response to an audit request.
Answer: D
Explanation: TAMs are usually issued to address request from IRS auditors.
Page Ref.: C:1-13
Objective: 4

38) Which of the following courts is <u>not</u> a trial court for tax cases?
A) U.S. Bankruptcy Court
B) U.S. District Court
C) U.S. Tax Court
D) U.S. Court of Federal Claims
Answer: A
Explanation: Bankruptcy Court does not have jurisdiction for tax matters.
Page Ref.: C:1-14 and C:1-15
Objective: 4

39) The taxpayer need <u>not</u> pay the disputed tax in advance when the suit is initiated in
A) U.S. Court of Federal Claims.
B) U.S. Tax Court.
C) U.S. District Court.
D) both A and B
Answer: B
Explanation: Tax Court taxpayer does not have to pay disputed amount up front.
Page Ref.: C:1-14 and C:1-15
Objective: 4

40) If the U.S. Supreme Court decides to hear an appeal of a tax case, it will grant a
A) writ of appeal.
B) writ of certiorari.
C) writ of detainer.
D) writ of habeas corpus.
Answer: B
Explanation: Granting review by USSC is done via writ of certiorari.
Page Ref.: C:1-14 and C:1-15
Objective: 4

41) Tax Court memorandum decisions
A) cannot be appealed.
B) are not published.
C) have less precedential value than regular decisions.
D) usually deal with factual variations of issues litigated previously.
Answer: D
Explanation: Tax Court memos usually deal with factual variations of issues litigated previously.
Page Ref.: C:1-15 and C:1-17
Objective: 4

42) George's case was handled under the "small tax case procedure." He does not agree with the findings of the Tax Court. He would like to appeal the decision. Which one of the following is <u>true</u>?
A) There is no appeal.
B) He can appeal the case, but only if the amount of tax involved is greater than $5,000.
C) He would appeal first to the U.S. Court of Appeals for the Federal Circuit.
D) He would appeal first to the U.S. Court of Federal Claims.
Answer: A
Explanation: Small Tax Case do not allow appeal process.
Page Ref.: C:1-17
Objective: 4

43) Identify which of the following statements is false.
A) The acquiescence policy was adopted by the U.S. Tax Court to permit litigating parties to agree on the exact amount of the tax due.
B) Letter rulings are binding only with respect to the taxpayer requesting the ruling.
C) The small cases procedure of the U.S. Tax Court allows a less formal hearing but provides for no appeal.
D) The IRS may retroactively revoke an acquiescence.
Answer: A
Explanation: Acquiescence policy the party states it does not agree but will not appeal the decision.
Page Ref.: C:1-17
Objective: 4

44) The phrase "Entered under Rule 155" indicates that
A) the computation of the exact amount of the tax deficiency has been left to the litigating parties.
B) the court has not reached a decision concerning the appropriate tax treatment of an issue.
C) the parties have agreed not to appeal the decision.
D) only one Tax Court judge reviewed the case.
Answer: A
Explanation: Rule 155 allows computation of exact amount been left to the litigating parties.
Page Ref.: C:1-17
Objective: 4

45) Small case procedures of the U.S. Tax Court requires that the amount in dispute not exceed
A) $5,000.
B) $10,000.
C) $50,000.
D) $100,000.
Answer: C
Explanation: Small tax court cap is $50,000.
Page Ref.: C:1-17
Objective: 4

46) The acquiescence policy of the IRS extends to the
A) U.S. Supreme Court decisions.
B) U.S. Tax Court regular decisions.
C) U.S. District Court decisions.
D) both B and C
Answer: D
Explanation: IRS cannot appeal USSC decisions.
Page Ref.: C:1-17
Objective: 4

47) A tax case cannot be appealed when initiated in the
A) U.S. Court of Federal Claims.
B) U.S. Tax Court.
C) U.S. Tax Court using the small case procedures.
D) none of the above
Answer: C
Explanation: Small tax case does not allow appeal.
Page Ref.: C:1-17
Objective: 4

48) Identify which of the following statements is false.
A) Regular and memorandum decisions of the Tax Court are published by the government in the Tax Court of the United States Reports.
B) The citation Cristofani, 97 T.C. 74 (1991) indicates that the decision is a regular decision of the Tax Court.
C) The citation Estate of Newhouse, 94 T.C. 193 (1990), nonacq. 1991-1 C.B. 1 indicates that the IRS did not formally disagree with this 1990 Tax Court decision until 1991.
D) The Board of Tax Appeals preceded the Tax Court.
Answer: A
Explanation: Tax Court decisions are not published in this reporter.
Page Ref.: C:1-17
Objective: 4

49) You need to locate a recent tax case that was tried in a Federal district court. The decision is an "unreported" decision. This means the decision was
A) not published in the Federal Supplement.
B) not published in American Federal Tax Reports.
C) not published in United States Tax Cases.
D) settled out of court.
Answer: A
Explanation: Unreported means it was not published in the Federal Supplement.
Page Ref.: C:1-18
Objective: 4

50) A jury trial is permitted in the
A) U.S. District Court.
B) U.S. Tax Court.
C) U.S. Court of Federal Claims.
D) U.S. Tax Court when the small case procedures are used.
Answer: A
Explanation: A district court is the only forum in which the taxpayer may have a jury decide questions of fact.
Page Ref.: C:1-18
Objective: 4

51) Which of the following citations is the primary citation for a U.S. District Court case?
A) 43 AFTR 2d 79-1023
B) 79-1 USTC &9323
C) 55 F.2d 930
D) 40 F.Supp. 453
Answer: D
Explanation: Federal Supplement is primary citation for US district court.
Page Ref.: C:1-19
Objective: 4

52) Identify which of the following statements is true.
A) The citation, 41 TCM 1272, refers to a Tax Court regular decision published by Commerce Clearing House.
B) The Federal Supplement contains only tax cases.
C) The American Federal Tax Reports contain only tax cases.
D) All of the above are false.
Answer: C
Explanation: American Federal Tax Reports contain only tax cases.
Page Ref.: C:1-19
Objective: 4

53) Identify which of the following statements is true.
A) The U.S. Court of Federal Claims hears cases only in Washington, D.C.
B) Each state has at least one U.S. District Court.
C) Federal district court decisions and federal courts of appeals decisions are not printed by the U.S. Government Printing Office.
D) All of the above are false.
Answer: B
Explanation: While some states have more than one district court due to the size of the State, every state has at least one district court.
Page Ref.: C:1-18
Objective: 4

54) Identify which of the following statements is false.
A) Citations to the AFTR and the USTC are referred to as secondary citations.
B) A circuit court of appeals must follow the opinion of another circuit court of appeals if the latter appeals court has previously ruled on the tax issue.
C) A U.S. Supreme Court opinion in a tax matter has the same status as Congressional tax legislation.
D) Circuit Court decisions are reported in the Federal Reporter.
Answer: B
Explanation: Each circuit court is independent of other circuit courts.
Page Ref.: C:1-20
Objective: 4

55) Identify which of the following statements is false.
A) The U.S. Tax Court must follow the previous decisions of the U.S. District Court for the district in which the taxpayer lives.
B) The U.S. Tax Court follows the previous decisions of the U.S. Court of Appeals to which the tax matter is appealable.
C) The opportunity for "forum shopping" occurs when different precedents on the same point exist.
D) The U.S. Tax Court may intentionally issue conflicting decisions.
Answer: A
Explanation: US Tax Court is not bound by US District Court decisions.
Page Ref.: C:1-21
Objective: 4

56) The Tax Court departs from its general policy of ruling uniformly for all taxpayers where
A) a U.S. District Court has ruled differently on the issue in the taxpayer's jurisdiction.
B) the U.S. Court of Federal Claims has ruled differently on the issue in the taxpayer's jurisdiction.
C) the Court of Appeals in the circuit to which the Tax Court decision would be appealed has ruled differently on the issue.
D) the IRS has indicated that it will acquiesce.
Answer: C
Explanation: Tax Court will generally follow the precedent of Court of Appeals for its district.
Page Ref.: C:1-21
Objective: 4

57) Identify which of the following statements is false.
A) When a court opinion discusses facts and issues on which the court does not rule, the comments are called *dicta*.
B) *Dicta* in a court opinion has no influence on other tax proceedings.
C) Published articles and tax services are examples of secondary sources of authority.
D) *Dicta* are not authoritative.
Answer: B
Explanation: Dicta is a court opinion with influence on other court proceedings.
Page Ref.: C:1-23
Objective: 4

58) When a court discusses issues not raised by the facts, the comments
A) are excluded from the formal court opinion.
B) may be referenced by the parties in other cases having the same facts.
C) are not *dicta*.
D) will cause the court's decision to be declared invalid.
Answer: B
Explanation: Court has discretion to reference other cases having same facts.
Page Ref.: C:1-23
Objective: 4

59) Which of the following is a true statement regarding primary authority of tax law?
A) Articles in The Journal of Taxation are viewed as primary authority.
B) Primary authority includes the Code, as well as administrative and judicial interpretations.
C) The Bloomberg BNA Daily Tax Reporter is a source of primary tax authority.
D) Tax services are sources of primary tax authority.
Answer: B
Explanation: Primary authority originates with IRC, administrative and judicial interpretations.
Page Ref.: C:1-24
Objective: 4

60) Which of the following is secondary authority?
A) Internal Revenue Code
B) Treasury Regulations
C) RIA and CCH tax services
D) Revenue Ruling
Answer: C
Explanation: Third-party sources are secondary authority.
Page Ref.: C:1-24
Objective: 4

61) Explain how committee reports can be used in tax research. What do they indicate?
Answer: Committee reports can help resolve ambiguities in statutory language by revealing Congressional intent. They are indicative of this intent.
Page Ref.: C:1-7
Objective: 4

62) In 1998, Congress passed legislation concerning shifting the burden of proof to the IRS. The taxpayer must introduce "credible evidence" to shift the burden of proof to the IRS. What constitutes "credible evidence"?
Answer: The term is not defined in the IRC. Because the provision is relatively new, few courts have had an opportunity to interpret what "credible evidence" means. In the absence of relevant statutory or judicial authority, you might look to the committee reports to ascertain what Congress intended by the term. Senate Report No. 105-174 states that "credible evidence" means evidence of a quality, which, "after critical analysis, the court would find sufficient upon which to base a decision on the issue if no contrary evidence were submitted."
Page Ref.: C:1-7 and C:1-8; Example C:1-4
Objective: 4

63) Does Title 26 contain statutory provisions dealing only with income taxation? Explain.
Answer: No; Title 26 deals with all taxation matters, not just income taxation. It covers estate tax, gift tax, employment tax, alcohol and tobacco tax, and excise tax matters.
Page Ref.: C:1-8
Objective: 4

64) What is the purpose of Treasury Regulations?
Answer: The Treasury Department issues regulations that expound upon the IRC. Treasury Regulations often contain examples with computations that provide valuable assistance in understanding the statutory language.
Page Ref.: C:1-9
Objective: 4

65) Why should tax researchers take note of the date on which a Treasury Regulation was adopted?
Answer: Researchers should note the date on which a Treasury Regulation was adopted because the IRC may have been revised subsequent to the date of adoption. That is, the regulation may not interpret the current version of the IRC. Discrepancies between the IRC and the regulation occur when the Treasury Department has not updated the regulation to reflect the current statute.
Page Ref.: C:1-9 and C:1-10
Objective: 4

66) Discuss the purposes and scope of temporary regulations.
Answer: Temporary regulations are issued by the Treasury Department after statutory changes have occurred to give guidance with respect to procedural and computational matters. Temporary regulations are also issued as proposed regulations with the same authoritative value as final regulations.
Page Ref.: C:1-9
Objective: 4

67) What are the purposes of citations in tax research?
Answer: Citations serve two purposes. First, they substantiate propositions, and second, they enable the reader to locate underlying authority.
Page Ref.: C:1-11
Objective: 4

68) Are letter rulings of precedential value to third parties?
Answer: Not really. A letter ruling is binding only on the taxpayer to whom the ruling was issued. However, the rulings can be useful in proving insights as to the IRS opinion about the tax consequences of various transactions.
Page Ref.: C:1-12 and C:1-13
Objective: 4

69) What is the difference between a taxpayer-requested letter ruling and a technical advice memorandum issued as a letter ruling?
Answer: A taxpayer-requested letter ruling deals with prospective transactions, whereas a TAM deals with past or consummated transactions.
Page Ref.: C:1-12 and C:1-13
Objective: 4

70) What is an information release?
Answer: The IRS issues information releases when it wants to release information to the general public. They are written in lay terms and are sent to thousands of newspapers throughout the country.
Page Ref.: C:1-13
Objective: 4

71) What are some of the factors to consider when deciding in which court to file a tax-related claim?
Answer: Factors to consider include each court's published precedents pertaining to the issue; the desirability of a jury trial; the tax expertise of each court; the effect on the taxpayer's cash flow.
Page Ref.: C:1-14 and C:1-15
Objective: 4

72) What are some of the consequences of the small cases procedure of the Tax Court?
Answer: The small cases procedure allows a taxpayer the advantage of having a day in court without the expense of an attorney. But if the taxpayer loses, the decision cannot be appealed.
Page Ref.: C:1-17
Objective: 4

73) Where must a tax researcher look to access all Tax Court cases?
Answer: The regular opinions are found in the Tax Court of the United States Reporter, published by the U.S. Government Printing Office, and the memo decisions are published by both RIA and CCH in their own court reporters.
Page Ref.: C:1-17
Objective: 4

74) Is it possible for the Tax Court to intentionally issue conflicting decisions?
Answer: Yes. If the Tax Court is issuing two decisions that are appealable to different circuit courts and these circuit courts have previously reached different conclusions on the issue, the Tax Court follows the respective precedent in each circuit and issues conflicting decisions. This is a result of the Golsen rule.
Page Ref.: C:1-21
Objective: 4

75) The Tax Court decides an expenditure is deductible in the year the issue was first litigated. The government appealed and won a reversal in the Ninth Circuit Court of Appeals. It is the only appellate decision regarding the issue. If and when the Tax Court encounters this issue again, how will it hold?
Answer: The Tax Court will hold that the expenditure is deductible except in the Ninth Circuit. The taxpayers in the Ninth Circuit will be denied the deduction.
Page Ref.: C:1-21; Example C:1-8
Objective: 4

76) Indicate which courts decided the case cited below. Also indicate on which pages and in which publications the authority is reported.

U.S. v. Maclin P. Davis, 397 U.S. 301, 25 AFTR 2d 70-827, 70-1 USTC & 9289 (1970).
Answer: This case appears in Vol. 397, page 301, of the United States Supreme Court Reports. It is also recorded in Vol. 25, pages 70-827, of the American Federal Tax Reports, Second Series, and in Vol. 1, paragraph 9289 of the 1970 CCH reporter the U.S. Tax Cases.
Page Ref.: C:1-21
Objective: 4

77) If the U.S. District Court for Rhode Island, the Tax Court, and the Eleventh Circuit have all ruled on a particular issue, then what precedents have been set for which courts in the future?
Answer: Any U.S. District court within the Eleventh Circuit must follow that circuit's decision. The U.S. District Court for Rhode Island must rule consistently with its previous ruling. Tax Court decisions are not binding on district courts, thus all district courts other than the one for Rhode Island and those in the Eleventh Circuit are free to decide the issue independently.
Page Ref.: C:1-21; Example C:1-9
Objective: 4

78) What is "forum-shopping"?
Answer: Forum-shopping involves choosing where among the various courts to file a lawsuit. Since courts often disagree as to the appropriate tax treatment of the same item, a taxpayer can file in the jurisdiction that has precedents that favor his circumstances.
Page Ref.: C:1-23
Objective: 4

79) Under what circumstances might a tax advisor find the provisions of a tax treaty useful?
Answer: A tax advisor might consult the provisions of a tax treaty if a U.S. taxpayer engages in transactions in a foreign country. The United States has tax treaties with about 55 countries.
Page Ref.: C:1-24
Objective: 4

80) Compare and contrast proposed, temporary, and final regulations.
Answer: Proposed regulations are not authoritative, but they do provide guidance concerning how the Treasury Department interprets the IRC. Temporary regulations, which have the same effect as final regulations, often are issued after major revisions to the IRC so that taxpayers and tax advisers will have guidance concerning procedural and/or computational matters. Final regulations, which are issued after the public has had time to comment on the proposed regulations, have nearly the same authoritative weight as the IRC.
Page Ref.: C:1-9
Objective: 4

81) Compare and contrast "interpretative" and "statutory" regulations.
Answer: Both types of regulations are issued by the Treasury Department. Interpretative regulations make the statutory language easier to understand and apply. Statutory regulations are issued when Congress delegates its rule-making authority to the Treasury Department. This delegation of authority is made explicitly in the legislation.

The courts are less likely to invalidate a statutory regulation than an interpretative regulation. The reluctance of the court to invalidate a statutory regulation is based on the recognition that Congress has abdicated its rule-making authority to the Treasury Department.
Page Ref.: C:1-10
Objective: 4

82) Explain the legislative reenactment doctrine.
Answer: Under the legislative reenactment doctrine, a Treasury Regulation is deemed to have been endorsed by Congress if the regulation was finalized before a related IRC provision was enacted, and during the interim, Congress did not amend the provision to which the regulation relates.
Page Ref.: C:1-10
Objective: 4

83) In which courts may litigation dealing with tax matters begin? Discuss the factors that might be considered in deciding where to begin litigation.
Answer: The Tax Court, the U.S. Court of Federal Claims, or the U.S. district court for the taxpayer's jurisdiction is where tax-related litigation may begin. The taxpayer would be interested in the precedent, if any, existing within each jurisdiction. The taxpayer might prefer to avoid parting with cash to pay the proposed deficiency. If so, the taxpayer would want to litigate in the Tax Court. If the taxpayer would like to have a jury trial address questions of fact, he or she should opt for the U.S. district court.
Page Ref.: C:1-14 and C:1-15
Objective: 4

84) Describe the appeals process in tax litigation.
Answer: Appeals from Tax Court and U.S. district court decisions are made to the circuit court of appeals for the taxpayer's jurisdiction. U.S. Court of Federal Claims decisions are appealable to the circuit court of appeals for the Federal Circuit. Appeals from any of the circuit courts of appeals may be brought to the U.S. Supreme Court.
Page Ref.: C:1-14 and C:1-15
Objective: 4

85) Discuss the differences and similarities between regular and memorandum decisions issued by the U.S. Tax Court.
Answer:
Differences:
1) Regular decisions involve an issue decided for the first time. A memorandum decision frequently involves a variation in the facts for an issue where the law has been previously decided.
2) The IRS's acquiescence policy extends to regular decisions but not to memorandum decisions.
3) Regular decisions are published by the U.S. Government Printing Office in the <u>Tax Court of the United States Reports</u>, while memorandum decisions are published by private companies.

Similarity:
1) Regular and memorandum decisions have the same precedential value.
Page Ref.: C:1-15 and C:1-17
Objective: 4

86) Assume that the Tax Court decided an expenditure in question was deductible. The government appealed to the Fifth Circuit, which reversed the decision and held it was not deductible. No other circuits have ruled on the issue.

A new case has just been filed in the Tax Court. How will the Tax Court rule if this new case is appealable to the Tenth Circuit? Would your answer be different if the case was appealable to the Fifth Circuit?
Answer: The <u>Golsen</u> rule provides that the Tax Court rules consistently with decisions of the circuit court of appeals to which the taxpayer's case is appealable. If the new case is appealable to the Tenth Circuit, the Tax Court will hold the expenditure is deductible, thereby following its own precedent. In a case appealable to the Fifth Circuit, the Tax Court will rule that it is not deductible, thereby following the appellate court's earlier decision.
Page Ref.: C:1-21
Objective: 4

LO5: Tax Services

1) Identify which of the following statements is true.
A) RIA United States Tax Reporter and CCH Standard Federal Tax Reporter are topical tax services.
B) An annotated tax service is organized by broad subject areas.
C) Annotations are summaries of IRS pronouncements and court opinions.
D) All of the above are false.
Answer: A
Explanation: These are third party secondary authority.
Page Ref.: C:1-25
Objective: 5

2) Which tax service is usually deemed to be the most authoritative?
A) United States Tax Reporter
B) Standard Federal Tax Reporter
C) Federal Tax Coordinator 2d
D) All are equally authoritative.
Answer: D
Explanation: All are published federal registers.
Page Ref.: C:1-25
Objective: 5

3) Distinguish between an annotated tax service and a topical tax service.
Answer: An annotated tax service is organized by IRC section. The IRC-arranged subdivisions of this service are likely to encompass several topics. A topical tax service is organized by broad topic. The topically arranged subdivisions of this service are likely to encompass several IRC sections.
Page Ref.: C:1-25
Objective: 5

LO6: The Internet as a Research Tool

1) Internet versions of topical tax services include
A) Code and Regulations.
B) Revenue rulings, letter rulings, and revenue procedures.
C) Court cases involving tax issues.
D) All of the above.
Answer: D
Explanation: Primary and secondary authorities are available online.
Page Ref.: C:1-26
Objective: 6

2) In list form, outline the steps to follow when using a tax service.
Answer:
1) Use a key word search.
2) Read the applicable material.
3) Check the supplementary (current developments) material.
4) Read the cases and rulings referenced in the database.
5) Use a citator to determine the current status of the relevant cases and rulings and if there are any additional cases and rulings.
6) Analyze the information; make analogies and reach a conclusion.
7) Communicate the conclusions to the client.
8) Refine the issues and perhaps return to step 1.
Page Ref.: C:1-27
Objective: 6

LO7: Citators

1) A citator enables tax researchers to locate authorities (e.g., cases and IRS pronouncements) that have cited a particular case.
Answer: TRUE
Explanation: Citators allow quick reference to the material.
Page Ref.: C:1-30
Objective: 7

2) Assume that you want to read a description of a particular area of the law, along with one or more illustrations of how that law is applied. You will not find that type of material in
A) a citator.
B) the Treasury Regulations.
C) the Cumulative Bulletin.
D) the Committee Reports.
Answer: A
Explanation: Citators do not provide explanations.
Page Ref.: C:1-30
Objective: 7

3) Why does a researcher use a citator?
A) to check on authorities issued subsequent to a court decision
B) to determine whether a private letter ruling exists on the subject
C) for examples of the application of a tax provision
D) none of the above
Answer: A
Explanation: Citators allow research determine if case is referenced other places.
Page Ref.: C:1-30
Objective: 7

4) A citator is used to find
A) the judicial history of a case.
B) the cases that have cited a case subsequent to the issuance of the opinion.
C) whether a case has been overturned.
D) all of the above.
Answer: D
Explanation: Citators show history, if cited other places and if still good law.
Page Ref.: C:1-30
Objective: 7

5) What is the minimum information that should be contained in a citation?
Answer: A citation should contain, at a minimum, the name of the case, the reporter that publishes the case, a volume number, a page or paragraph number, the year the case was decided, and the court that decided the case.
Page Ref.: C:1-30
Objective: 7

6) What is the purpose of a citator?
Answer: Citators give a history of the case, and they list other authorities such as other cases or revenue rulings that cite the case in question.
Page Ref.: C:1-30
Objective: 7

LO8: Professional Guidelines for Tax Services

1) According to the Statements on Standards for Tax Services, CPAs must verify all tax return information submitted by reviewing client documentation.
Answer: FALSE
Explanation: The CPA may in good faith rely on information provided by the taxpayer, without verifying the reliability of that information if reasonable inquiries are made where the information furnished appears to be incorrect.
Page Ref.: C:1-31
Objective: 8

2) Which of the following statements about the Statements on Standards for Tax Services is true?
A) A CPA is never allowed to use a taxpayer's estimates when preparing a tax return.
B) The CPA must tell the IRS upon becoming aware that an error has been made on a past tax return.
C) The CPA may in good faith rely on information provided by the taxpayer, without verifying the reliability of that information if reasonable inquiries are made where the information furnished appears to be incorrect.
D) The CPA should not recommend that a taxpayer take a certain position if there is any doubt as to whether the position would be approved by the IRS upon audit.
Answer: C
Explanation: The CPA may in good faith rely on information provided by the taxpayer, without verifying the reliability of that information if reasonable inquiries are made where the information furnished appears to be incorrect.
Page Ref.: C:1-31 through C:1-33
Objective: 8

3) Statements on Standards for Tax Services are issued by
A) the SEC.
B) the IRS.
C) the AICPA.
D) the FASB.
Answer: C
Explanation: The AICPA issues Statements on Standards for Tax Services.
Page Ref.: C:1-31
Objective: 8

4) A client wants to take a tax return position with less than a 10% probability of being upheld in court. The CPA should
A) take the client's desired position, but not sign the tax return.
B) inform the client that the position does not have a realistic possibility of success.
C) ask the client to sign a waiver of his right to sue the CPA in the event the IRS disallows the position.
D) take the client's desired position and sign the return as usual.
Answer: B
Explanation: A CPA should inform a client the position does not have realistic change of success for tax return position with less than a 10% probability of being upheld in court.
Page Ref.: C:1-31
Objective: 8

5) According to the Statements on Standards for Tax Services, if a CPA believes that a client's prior-year tax return contains false information, the CPA should report this to the
A) IRS.
B) SEC.
C) AICPA.
D) None of the above. The CPA does not report the false information to any external agencies, unless required by law.
Answer: D
Explanation: The CPA does not report the false information to any external agencies, unless required by law.
Page Ref.: C:1-32 through C:1-33
Objective: 8

6) Ralph's business records were lost as a result of Hurricane Katrina. CPA Jane prepares Ralph's return using estimates. What do the Statements on Standards for Tax Services state about the use of estimates?
A) Estimates may not be used.
B) Estimates may be used without disclosing their use to the IRS.
C) Estimates may be used, but Jane should disclose their use to the IRS.
D) The Statements on Standards for Tax Services do not address the use of estimates.
Answer: C
Explanation: Estimates may be used but must be disclosed to the IRS.
Page Ref.: C:1-32
Objective: 8

7) During the course of an audit, a CPA discovers an error in a prior return. According to the Statements on Standards for Tax Services, the CPA should
A) ask the client for permission to disclose the error to the IRS.
B) withdraw from the engagement.
C) inform the IRS of the error, regardless of whether the client grants permission.
D) correct the error in the current year's tax return.
Answer: A
Explanation: CPA must get permission.
Page Ref.: C:1-32 through C:1-33
Objective: 8

8) According to the Statements on Standards for Tax Services, what belief should a CPA have before taking a pro-taxpayer position on a tax return?
Answer: The CPA should have a good faith belief that the pro-taxpayer position is warranted in existing law or can be supported by a good-faith argument for an extension, modification, or reversal of existing law. The position should have a realistic possibility of being sustained administratively or judicially on its merits if challenged.
Page Ref.: C:1-31
Objective: 8

9) According to the AICPA's Statements on Standards for Tax Services, what duties does the tax practitioner owe the client?
Answer: The tax practitioner owes the client the following duties: (1) to inform the client of (a) the potential adverse consequences of a tax return position, (b) how the client can avoid a penalty through disclosure, (c) errors in a previously filed tax return, and (d) corrective measures to be taken; (2) to inquire of the client (a) when the client must satisfy conditions to take a deduction and (b) when information provided by him or her appears incorrect, incomplete, or inconsistent on its face, and (3) not to disclose tax-related errors without the client's consent.
Page Ref.: C:1-31 through C:1-33
Objective: 8

10) Your client wants to deduct commuting expenses on his tax return. You explain to the client that there is no legal authority allowing this deduction. The client, however, continues to insist on this action. What guidance do the Statements on Standards for Tax Services provide in this dilemma?
Answer: According to Statement on Tax Standards, the CPA should explain to the client that this action is a violation of the tax law and would trigger IRS penalties. If the client insists on the deduction, the CPA should consider withdrawing from the engagement.
Page Ref.: C:1-31 through C:1-33
Objective: 8

11) Discuss the conflict between advocacy for a client and responsibility to the IRS.
Answer: The CPA's primary duty is to his or her client, not the IRS. The CPA should provide quality advice based on sound legal authority. CPAs do not have to verify client data unless it appears inconsistent, erroneous, or incomplete. CPAs also are not required to report most potential tax law violations to the IRS. If a client refuses to correct a tax-related error, the CPA may terminate the relationship.
Page Ref.: C:1-31 through C:1-33
Objective: 8

LO9: Sample Work Papers and Client Letter

1) There are no questions for this section.

***Pearson's Federal Taxation 2025: Individuals, 38e* (Richardson)**
Chapter I1: An Introduction to Taxation

LO1: History of Taxation in the United States

1) The federal income tax is the dominant form of taxation by the federal government.
Answer: TRUE
Explanation: The federal income tax provides more revenues than any other tax.
Page Ref.: I:1-2
Objective: 1

2) The Sixteenth Amendment to the U.S. Constitution permits the passage of a federal income tax law.
Answer: TRUE
Explanation: The Sixteenth Amendment amended the Constitution to permit the imposition of an income tax.
Page Ref.: I:1-2
Objective: 1

3) When a change in the tax law is deemed necessary by Congress, the entire Internal Revenue Code must be revised.
Answer: FALSE
Explanation: The federal income tax law is changed on an incremental basis.
Page Ref.: I:1-3
Objective: 1

4) The largest source of federal revenues is the corporate income tax.
Answer: FALSE
Explanation: The largest source is the individual income tax.
Page Ref.: I:1-3
Objective: 1

5) Until about 100 years ago, attempts to impose a federal income tax were ruled unconstitutional. The amendment to the U.S. Constitution allowing the imposition of a federal income tax is the
A) Second Amendment.
B) Thirteenth Amendment.
C) Sixteenth Amendment.
D) Nineteenth Amendment.
Answer: C
Explanation: The Sixteenth Amendment, ratified in 1913, gave Congress the power to impose a federal income tax.
Page Ref.: I:1-2
Objective: 1

6) The largest source of revenues for the federal government comes from
A) individual income taxes.
B) corporate income taxes.
C) Social Security and Medicare taxes (FICA).
D) estate and gift taxes.
Answer: A
Explanation: The individual income tax has provided the largest source of revenues for many years.
Page Ref.: I:1-3
Objective: 1

LO2: Types of Tax Rate Structures

1) A progressive tax rate structure is one where the rate of tax increases as the tax base increases.
Answer: TRUE
Explanation: Under a progressive tax system, the rate increases as the tax base increases.
Page Ref.: I:1-4
Objective: 2

2) The terms "progressive tax" and "flat tax" are synonymous.
Answer: FALSE
Explanation: A proportional, not progressive, tax and flat tax are synonymous.
Page Ref.: I:1-4
Objective: 2

3) A proportional tax rate is one where the rate of the tax is the same for all taxpayers, regardless of income levels.
Answer: TRUE
Explanation: A proportional tax is essentially a flat tax.
Page Ref.: I:1-4
Objective: 2

4) Regressive tax rates decrease as the tax base increases.
Answer: TRUE
Explanation: Regressive rates increase as the base decreases.
Page Ref.: I:1-5
Objective: 2

5) The marginal tax rate is useful in tax planning because it measures the tax effect of a proposed transaction.
Answer: TRUE
Explanation: The marginal rate applies to the planned addition to income or reduction to income.
Page Ref.: I:1-5
Objective: 2

6) A taxpayer's average tax rate is the tax rate applied to an incremental amount of taxable income that is added to the tax base.
Answer: FALSE
Explanation: The marginal tax rate is the tax rate applied to an incremental amount of taxable income.
Page Ref.: I:1-5
Objective: 2

7) If a taxpayer's total tax liability is $30,000, taxable income is $100,000, and economic income is $120,000, the average tax rate is 30 percent.
Answer: TRUE
Explanation: The average rate equals the tax liability divided by the taxable income.
Page Ref.: I:1-5
Objective: 2

8) If a taxpayer's total tax liability is $4,000, taxable income is $20,000, and total economic income is $40,000, then the effective tax rate is 20 percent.
Answer: FALSE
Explanation: The effective rate would be $4,000/$40,000 = 10 percent.
Page Ref.: I:1-6
Objective: 2

9) Arthur pays tax of $5,000 on taxable income of $50,000 while taxpayer Barbara pays tax of $12,000 on $120,000. The tax is a
A) progressive tax.
B) proportional tax.
C) regressive tax.
D) None of the above.
Answer: B
Explanation: The tax rate is proportional because the 10% tax rate applies to both taxpayers regardless of their income level.
Page Ref.: I:1-4; Example I:1-3
Objective: 2

10) Which of the following taxes is progressive?
A) sales tax
B) excise tax
C) property tax
D) federal income tax
Answer: D
Explanation: Federal income tax rates increase as a taxpayer's taxable income rises.
Page Ref.: I:1-4; Topic Review I:1-1
Objective: 2

11) Which of the following taxes is proportional?
A) gift tax
B) income tax
C) sales tax
D) Federal Insurance Contributions Act (FICA)
Answer: C
Explanation: A sales tax is assessed at a fixed rate of the purchase amount, based on state and local law.
Page Ref.: I:1-4; Topic Review I:1-1
Objective: 2

12) Which of the following taxes is regressive?
A) Federal Insurance Contributions Act (FICA)
B) excise tax
C) property tax
D) gift tax
Answer: A
Explanation: For upper income wage earners, the Social Security tax ceases at a maximum wage base. For 2024, wages over $168,600 are not subject to the Social Security tax.
Page Ref.: I:1-5; Topic Review I:1-1
Objective: 2

13) The corporate tax rate is
A) progressive.
B) regressive.
C) proportional.
D) None of the above.
Answer: C
Explanation: The corporate tax rate is a flat 21 percent.
Page Ref.: I:1-5
Objective: 2

14) Sarah contributes $25,000 to a church. Sarah's marginal tax rate is 35% while her average tax rate is 25%. After considering her tax savings, Sarah's contribution costs
A) $6,250.
B) $8,750.
C) $16,250.
D) $18,750.
Answer: C
Explanation: [$25,000 × (100% - 35%)] = $16,250
Page Ref.: I:1-5; Example I:1-4
Objective: 2

15) Helen, who is single, is considering purchasing a residence that will provide an $18,000 tax deduction for property taxes and mortgage interest. If her marginal tax rate is 24% and her effective tax rate is 20%, what is the amount of Helen's tax savings from purchasing the residence?
A) $3,600
B) $4,320
C) $3,200
D) $18,000
Answer: B
Explanation: $18,000 × .24 marginal rate = $4,320 tax savings.
Page Ref.: I:1-5; Example I:1-4
Objective: 2

16) Charlotte pays $8,000 in tax deductible property taxes. Charlotte's marginal tax rate is 24%, effective tax rate is 20% and average rate is 22%. Charlotte's tax savings from paying the property tax is
A) $1,600.
B) $1,760.
C) $1,920.
D) $8,000.
Answer: C
Explanation: $8,000 × 0.24 = $1,920
Page Ref.: I:1-5; Example I:1-4
Objective: 2

17) Briana, who is single, has taxable income for 2024 of $90,000, resulting in a total tax of $14,853. Her total economic income is $100,000. Briana's average tax rate and effective tax rate are, respectively,
A) 16.50% and 14.85%.
B) 16.50% and 22%.
C) 14.85% and 22%.
D) 14.85% and 16.50%.
Answer: A
Explanation: Average tax rate: $14,853 ÷ $90,000 = 16.50%
Effective tax rate: $14,853 ÷ $100,000 = 14.85%
Page Ref.: I:1-5 and I:1-6; Example I:1-5
Objective: 2

18) Larry and Ally are married and file a joint return. They are considering purchasing a personal residence that will generate two deductions: $10,000 in home mortgage interest and $8,000 in real estate taxes. Their marginal tax rate is 24%. What is the total tax savings if Larry and Ally purchase the residence?
Answer: ($10,000 + $8,000) × .24 = $4,320
Page Ref.: I:1-5; Example I:1-4
Objective: 2

19) Larry and Ally are married and file a joint return. They are considering purchasing a personal residence that will generate two deductions: $10,000 in home mortgage interest and $8,000 in real estate taxes. Their marginal tax rate is 24%. If Larry and Ally purchase the residence, what will be the after-tax cost of this additional $18,000 in expenditures?
Answer: Tax savings of expenditures: ($10,000 + $8,000) × .24 = $4,320
After-tax cost: $18,000 - $4,320 = $13,680
Page Ref.: I:1-5; Example I:1-4
Objective: 2

LO3: Other Types of Taxes

1) All states impose a state income tax which is generally based on an individual's federal adjusted gross income (AGI) with minor adjustments.
Answer: FALSE
Explanation: While many states impose a state income tax, not all states do. In those states that do impose tax, the taxes vary greatly in both form and rates.
Page Ref.: I:1-7
Objective: 3

2) The unified transfer tax system, comprised of the gift and estate taxes, is based upon the total property transfers an individual makes during lifetime and at death.
Answer: TRUE
Explanation: Gift and estate taxes, which comprise a unified transfer tax system, are based on cumulative transfers.
Page Ref.: I:1-7
Objective: 3

3) Gifts between spouses are generally exempt from transfer taxes.
Answer: TRUE
Explanation: The tax law allows for unlimited transfers between spouses.
Page Ref.: I:1-8
Objective: 3

4) The primary liability for payment of the gift tax is imposed upon the donee.
Answer: FALSE
Explanation: The gift tax is imposed on the donor.
Page Ref.: I:1-8
Objective: 3

5) For gift tax purposes, a $18,000 annual exclusion per donee is permitted in 2024.
Answer: TRUE
Explanation: Donors are allowed to exclude $18,000 per donee per year for gift tax purposes.
Page Ref.: I:1-8
Objective: 3

6) In 2024, an individual will be subject to gift tax on gifts made to a charity greater than $18,000.
Answer: FALSE
Explanation: Contributions to charity are not limited by the gift tax exclusion.
Page Ref.: I:1-8
Objective: 3

7) Property is generally included on an estate tax return at its historical cost basis.
Answer: FALSE
Explanation: Property is generally valued at fair market value at date of death or the alternate valuation date.
Page Ref.: I:1-10
Objective: 3

8) Property transferred to the decedent's spouse is exempt from the estate tax because of the estate tax marital deduction provision.
Answer: TRUE
Explanation: The estate and gift tax law allows tax exempt transfers to spouses.
Page Ref.: I:1-10
Objective: 3

9) Gifts made during a taxpayer's lifetime may affect the amount of estate tax paid by the taxpayer's estate.
Answer: TRUE
Explanation: Gift and estate taxes are applied to cumulative transfers under the uniform tax system.
Page Ref.: I:1-10
Objective: 3

10) While federal and state income taxes, as well as the federal gift and estate taxes, are generally progressive in nature, property taxes are proportional.
Answer: TRUE
Explanation: Property taxes are assessed on the value of property and are proportionate to the value of the property.
Page Ref.: I:1-11
Objective: 3

11) The unified transfer tax system
A) imposes a single tax upon transfers of property during an individual's lifetime only.
B) imposes a single tax upon transfers of property during an individual's life and at death.
C) imposes a single tax upon transfers of property only at an individual's death.
D) None of the above.
Answer: B
Explanation: The gift (transfers during life) tax and estate (transfers after death) tax systems are unified.
Page Ref.: I:1-7
Objective: 3

12) When property is transferred, the gift tax is based on
A) replacement cost of the transferred property.
B) fair market value on the date of transfer.
C) the transferor's original cost of the transferred property.
D) the transferor's depreciated cost of the transferred property.
Answer: B
Explanation: The gift tax is based on the property's fair market value on the date of transfer.
Page Ref.: I:1-8
Objective: 3

13) Paul makes the following property transfers in 2024:

- $22,000 cash to his wife
- $34,000 cash to a qualified charity
- $220,000 house to his son
- $3,000 computer to an unrelated friend

The total of Paul's taxable gifts, assuming he does not elect gift splitting with his spouse, subject to the unified transfer tax is
A) $202,000.
B) $205,000.
C) $224,000.
D) $236,000.
Answer: A
Explanation: $220,000 - $18,000 = $202,000. The gift to the unrelated friend is below the $18,000 annual gift tax exclusion. The gifts to his wife and to the charity are not subject to gift tax.
Page Ref.: I:1-8; Example I:1-6
Objective: 3

14) Charlie makes the following gifts in 2024: $40,000 to his spouse, $30,000 to his church, $20,000 to his nephew, and $25,000 to a friend. Assuming Charlie does not elect gift splitting with his wife, his taxable gifts in the current year will be
A) $21,000.
B) $9,000.
C) $31,000.
D) $43,000.
Answer: B
Explanation: ($20,000 - $18,000) + (25,000 - $18,000) = $9,000. The gift to his spouse and the charitable gift are not subject to gift taxes.
Page Ref.: I:1-8; Example I:1-6
Objective: 3

15) Shaquille buys new cars for five of his friends during 2024. Each car cost $70,000. What is the amount of Shaquille's taxable gifts?
A) $0
B) $260,000
C) $265,000
D) $350,000
Answer: B
Explanation: 5 × ($70,000 - $18,000) = $260,000
Page Ref.: I:1-8; Example I:1-6
Objective: 3

16) In 2024, an estate is not taxable unless the sum of the taxable estate and taxable gifts made after 1976 exceeds
A) $5,113,800.
B) $12,920,000.
C) $5,389,800.
D) $13,610,000.
Answer: D
Explanation: The unified credit equivalent for estate and gift taxes is $13,610,000 for 2024. This exclusion amount equates to a unified credit of $5,389,800.
Page Ref.: I:1-9; Example I:1-7
Objective: 3

17) Eric dies in 2024 and has a gross estate valued at $16,500,000. The estate incurs funeral and administrative expenses of $100,000 and also pays off Eric's debts which amount to $250,000. Eric bequeaths $600,000 to his wife. Eric made no taxable transfers during his life. Eric's taxable estate will be
A) $2,630,000.
B) $15,550,000.
C) $2,880,000.
D) $16,500,000.
Answer: B
Explanation: ($16,500,000 - $100,000 - $250,000 - $600,000) = $15,550,000
Page Ref.: I:1-10; Example I:1-8
Objective: 3

18) Jose dies in 2024 and has a gross estate valued at $13,000,000. Over the past ten years, Jose had made taxable gifts of $400,000. The estate incurs funeral and administrative expenses of $100,000 and also pays off Jose's debts which amount to $300,000. Jose bequeaths $500,000 to his wife. What is the amount of Jose's tax base, the amount on which the estate tax is computed?
A) $12,100,000
B) $12,500,000
C) $0
D) $80,000
Answer: B
Explanation: $13,000,000 - $100,000 funeral/administrative expense - $300,000 liabilities - $500,000 marital transfers = $12,100,000 taxable estate + $400,000 gifts = $12,500,000 tax base
Page Ref.: I:1-10; Example I:1-8
Objective: 3

19) Which of the following statements is <u>incorrect</u>?
A) Property taxes are levied on real estate.
B) Excise taxes are assessed on items such as gasoline and telephone use.
C) Gift taxes are generally imposed on the recipient of a gift.
D) The estate tax is based on the fair market value of property at death or the alternate valuation date.
Answer: C
Explanation: Gift taxes are imposed on the donor of a gift, not the recipient.
Page Ref.: I:1-8 through I:1-11
Objective: 3

20) Kole earns $170,000 in 2024 in his job as a sales manager. What is his FICA tax?
A) $12,918
B) $10,063
C) $12,255
D) $13,005
Answer: A
Explanation: (168,600 × .062) + (170,000 × .0145) = $12,918
Page Ref.: I:1-11
Objective: 3

21) Jillian, a single individual, earns $230,000 in 2024 through her job as an accounting manager. What is her FICA tax?
A) $14,058
B) $13,267
C) $17,595
D) $17,865
Answer: A
Explanation: (168,600 × .062) + (230,000 × .0145) + ((230,000 - 200,000) × .009) = $14,058
Page Ref.: I:1-11
Objective: 3

22) Martha is self-employed in 2024. Her self employment income is $170,000. What is her self-employment tax?
A) $26,010
B) $25,836
C) $24,511
D) None of the above.
Answer: B
Explanation: (168,600 × .124) + (170,000 × .029) = $25,836
Page Ref.: I:1-11
Objective: 3

23) Vincent makes the following gifts during 2024:
Gift of $15,000 cash to wife
Gift of automobile valued at $35,000 to his adult son
Gift of golf clubs valued at $5,000 to a friend
Contribution of $10,000 to church

Although he is married, none of the gifts are considered joint gifts with his wife. What are the total taxable gifts subject to the unified transfer tax?
Answer:

	Gift Value	Adjustment	Taxable Gift
Cash to wife	$15,000	spousal gifts excluded	$ 0
Auto to son	35,000	less $18,000 exclusion	18,000
Golf clubs to friend	5,000	less $18,000 exclusion	0
Cash to church	10,000	charitable gifts excluded	0
Taxable gifts			$19,000

Page Ref.: I:1-8; Example I:1-6
Objective: 3

24) Jeffery died in 2024 leaving a $17,000,000 gross estate. Six months after his death, the gross assets are valued at $17,100,000. In years prior to 2024 (but after 1976), Jeffery had made taxable gifts of $300,000. Of the $17,000,000 gross estate, estate assets valued at $3 million were transferred to his wife and $100,000 was used to pay administrative and funeral expenses. Jeffery had debts of $200,000 which were paid by the estate, and the remainder of the estate was transferred to his children.
a. What is the amount of Jeffery's taxable estate?
b. What is the tax base for computing Jeffery's estate?
c. What is the amount of estate tax owed if the unified credit is $5,389,800?
d. Alternatively, if six months after his death, the gross assets in Jeffery's estate declined in value to $16,000,000, can the administrator of Jeffery's estate elect the alternate valuation date?
Answer:

Gross Estate	$17,000,000
Minus: Funeral and administrative expenses	(100,000)
Minus: Debts	(200,000)
Minus: Marital deduction	(3,000,000)
Taxable estate (a)	$13,700,000
Plus: Taxable gifts made after 1976	300,000
Tax base (b)	$14,000,000
Tentative tax on estate tax base $345,800 + [.4 × (14,000,000 - $1,000,000)]	$ 5,545,800
Minus: Tax credits (unified tax credit)	5,389,800
Unified transfer tax due (c)	$ 156,000

d. The alternate valuation date (six months after the date of death) may be elected only if the aggregate value of the gross estate decreases during the six-month period following the date of death and the election results in a lower estate tax liability. In this case, the alternate valuation date can be elected.
Page Ref.: I:1-10; Example I:1-8
Objective: 3

25) Mia is self-employed as a consultant. During 2024, Mia earned $180,000 in self-employment income. What is Mia's self-employment tax?
Answer:

.124 × $168,600 =	$20,906
.029 × $180,000 =	5,220
Self-employment tax	$26,126

Page Ref.: I:1-11
Objective: 4

LO4: Criteria for a Tax Structure

1) Adam Smith's canons of taxation are equity, certainty, convenience, and economy.
Answer: TRUE
Explanation: Adam Smith's canons of taxation include equity, certainty, convenience and economy.
Page Ref.: I:1-12
Objective: 4

2) The primary objective of the federal income tax law is to achieve various economic and social policy objectives.
Answer: FALSE
Explanation: The primary objective of the federal income tax law is to raise revenues for government operations.
Page Ref.: I:1-14
Objective: 4

3) Which of the following is not one of Adam Smith's canons of taxation?
A) equity
B) convenience
C) certainty
D) economic stimulation
Answer: D
Explanation: Smith's canons of taxation are equity, certainty, convenience and economy (in terms of administration of the tax system).
Page Ref.: I:1-12
Objective: 4

4) Horizontal equity means that
A) taxpayers with the same amount of income should pay the same amount of tax.
B) taxpayers with larger amounts of income should pay more tax than taxpayers with lower amounts of income.
C) all taxpayers should pay the same tax.
D) None of the above.
Answer: A
Explanation: Horizontal equity means that taxpayers with the same amount of income should pay the same amount of tax.
Page Ref.: I:1-13
Objective: 4

5) Vertical equity means that
A) taxpayers with the same amount of income should pay the same amount of tax.
B) taxpayers with larger amounts of income should pay more tax than taxpayers with lower amounts of income.
C) all taxpayers should pay the same tax.
D) None of the above.
Answer: B
Explanation: Vertical equity means that taxpayers with larger amounts of income should pay more tax than taxpayer's with lower amounts of income.
Page Ref.: I:1-13
Objective: 4

6) Which of the following is <u>not</u> an objective of the federal income tax law?
A) stimulate private investment
B) redistribution of wealth
C) encourage research and development activities
D) prevent taxpayers from paying a higher percentage of their income in personal income taxes due to inflation
Answer: B
Explanation: Redistribution of wealth is not an objective of the federal income tax law.
Page Ref.: I:1-14 and I:1-15
Objective: 4

7) Which of the following is <u>not</u> a social objective of the tax law?
A) prohibition of a deduction for illegal bribes, fines and penalties
B) a deduction for charitable contributions
C) an exclusion for interest earned by large businesses
D) creation of tax-favored pension plans
Answer: C
Explanation: There is no exclusion for interest income earned by large businesses.
Page Ref.: I:1-15
Objective: 4

8) A presidential candidate proposes replacing the income tax with a national sales tax. The sales tax would have a flat rate. Describe the impact of this change in terms of tax structure and equity.
Answer: The change would replace a progressive tax with a proportional tax. The national sales tax decreases vertical equity since taxpayers with higher income would not necessarily pay more in taxes. The sales tax would be based on consumption, not income. The impact of the sales tax is regressive since taxpayers with lower levels of income would pay a greater percentage of their income.
Page Ref.: I:1-3, I:1-4 and I:1-14; Topic Review I:1-1
Objective: 4

LO5: Entities in the Federal Income Tax System

1) Individuals are the principal taxpaying entities in the federal income tax system.
Answer: TRUE
Explanation: Revenues from income taxation of individuals far exceed those of other taxpayers.
Page Ref.: I:1-17
Objective: 5

2) The various entities in the federal income tax system may be classified into two general categories, *taxpaying entities* (such as individuals and C [regular] corporations) and *flow-through entities* such as sole proprietorships, partnerships, S corporations, and limited liability companies.
Answer: TRUE
Explanation: Certain business entities do not pay tax; the income is passed through to the business owners. The business owners pay the tax on the taxable income earned by the entity as part of their tax liability.
Page Ref.: I:1-17
Objective: 5

3) Dividends paid from most U.S. corporations are taxed at the same rate as the recipients' salaries and wages.
Answer: FALSE
Explanation: Qualifying dividends are taxed at a preferential rate.
Page Ref.: I:1-20
Objective: 5

4) Flow-through entities do not have to file tax returns since they are not taxable entities.
Answer: FALSE
Explanation: S Corporations, partnerships and limited liability companies have to file an informational tax return each year.
Page Ref.: I:1-20
Objective: 5

5) Organizing a corporation as an S Corporation results in a single level of taxation.
Answer: TRUE
Explanation: S Corporations do not pay tax. Owners of the corporation pay tax on their share of the corporation's taxable income, but do not pay tax on the distributions received.
Page Ref.: I:1-22
Objective: 5

6) In a limited liability partnership, a partner is not liable for his partner's acts of negligence or misconduct.
Answer: TRUE
Explanation: A partner in an LLP is liable for his own acts of negligence or misconduct, but not those of his partners.
Page Ref.: I:1-23
Objective: 5

7) Limited liability companies may elect to be taxed as corporations.
Answer: TRUE
Explanation: An LLC can affirmatively elect to be taxed as a corporation.
Page Ref.: I:1-23
Objective: 5

8) Limited liability company members (owners) are responsible for the liabilities of their limited liability company.
Answer: FALSE
Explanation: Limited liability company members have protection from entity-level liability in a manner similar to that of shareholders of corporations.
Page Ref.: I:1-23
Objective: 5

9) Which of the following is not a taxpaying entity?
A) C corporation
B) partnership
C) individual
D) All of the above are taxpayers.
Answer: B
Explanation: A partnership is a flow-through entity.
Page Ref.: I:1-16
Objective: 5

10) All of the following are classified as flow-through entities for tax purposes except
A) partnerships.
B) C corporations.
C) S corporations.
D) limited liability companies.
Answer: B
Explanation: A C corporation is a taxpaying entity.
Page Ref.: I:1-16
Objective: 5

11) Firefly Corporation is a C corporation. Freya owns all of the stock. During the current year Firefly earned taxable income of $500,000 and paid a $300,000 dividend to Freya. Which of the following statements is correct?
A) Firefly will pay corporate income tax on its earnings, and Freya will pay individual income tax on the dividends.
B) Only Firefly will pay taxes. Freya will not pay any taxes due to her holdings in Firefly.
C) Firefly's income will flow through to Freya's tax return, and she will pay the taxes on the $500,000 of corporate income.
D) Firefly will not pay any taxes, but Freya will pay taxes on the dividend received.
Answer: A
Explanation: The C corporation pays tax on its own taxable income, and then a second layer of tax is paid by the shareholders when dividends are paid to them.
Page Ref.: I:1-19 and I:1-20; Example I:1-15
Objective: 5

12) Rocky and Charlie form RC Partnership as equal partners. Rocky contributes $100,000 into RC while Charlie contributes real estate with a cost and fair market value of $100,000. During the current year, RC earned net income of $600,000. The partnership distributes $200,000 to each partner. The amount that Rocky should report on his individual tax return is
A) $0.
B) $100,000.
C) $200,000.
D) $300,000.
Answer: D
Explanation: Rocky must report 50% × $600,000 or $300,000, his share of partnership net income. The distribution of $200,000 is not taxable but rather a nontaxable return of capital reducing Rocky's basis ($100,000 original investment + $300,000 share of income) by $200,000 to $200,000.
Page Ref.: I:1-21; Example I:1-18
Objective: 5

13) AB Partnership earns $500,000 in the current year. Partners A and B are equal partners who do not receive any distributions during the year. How much income does partner A report from the partnership?
A) $0
B) $250,000
C) $500,000
D) None of the above.
Answer: B
Explanation: Partners are taxed on their share of partnership income, regardless of whether they receive a distribution. $500,000 × .5 = $250,000
Page Ref.: I:1-21; Example I:1-18
Objective: 5

14) In an S corporation, shareholders
A) are taxed on their proportionate share of earnings.
B) are taxed only on dividends.
C) may allocate income among themselves in order to consider special contributions.
D) are only taxed on salaries.
Answer: A
Explanation: Similar to partners in a partnership, S corporation shareholders are taxed on their proportionate share of the income earned by the corporation, regardless of distribution payments.
Page Ref.: I:1-22
Objective: 5

15) Fireball Corporation is an S corporation. Leyla owns all of the stock. During the current year, Fireball earned taxable income of $500,000 and paid a $300,000 distribution to Leyla. Which of the following statements is correct?
A) Fireball will pay corporate income tax on its earnings, and Leyla will pay individual income tax on the distribution.
B) Only Fireball will pay taxes. Leyla will not pay any taxes due to her holdings in Fireball.
C) Fireball's income will flow through to Leyla's tax return, and she will pay the taxes on the $500,000 of corporate income.
D) Fireball will not pay any taxes, but Leyla will pay taxes on the distribution received.
Answer: C
Explanation: Similar to partners in a partnership, S corporation shareholders are taxed on their proportionate share of the income earned by the corporation, regardless of distribution payments.
Page Ref.: I:1-22; Example I:1-19
Objective: 5

16) All of the following statements are true except
A) the net income earned by a sole proprietorship is reported on the owner's individual income tax return.
B) the net income of an S corporation is subject to double taxation because it is taxed at the entity level and dividends paid from the S corporation to individual shareholders are also taxed.
C) the net income of C corporation is subject to double taxation because it is taxed at the entity level and dividends paid from the C corporation to individual shareholders is also taxed.
D) LLCs are generally taxed as partnerships.
Answer: B
Explanation: An S corporation is a flow-through entity, not a taxable entity. The items of income/loss are allocated to each shareholder who pays tax on the items on his or her individual income tax return.
Page Ref.: I:1-17 through I:1-23
Objective: 5

17) Tercot Partnership reported $1,000,000 of business receipts, $700,000 of business deductions, and $100,000 of interest income. Terry is a 50% partner in Tercot Partnership. On Terry's return, she will be entitled to a deduction for qualified business income of
A) $60,000.
B) $80,000.
C) $40,000.
D) $30,000.
Answer: D
Explanation: Tercot's business income is $300,000 ($1,000,000 business receipts - $700,000 business deductions; interest income is not included). Terry's share of the business income is $150,000. The qualified business income deduction is 20% of the $150,000.
Page Ref.: I:1-20; Example I:1-16
Objective: 5

18) Signal Corporation is an S corporation owned equally by Serena and three other shareholders. The corporation reported $900,000 of business receipts, $500,000 of business deductions and $40,000 of dividend income. On Serena's return, she will be entitled to a deduction for qualified business income of
A) $20,000.
B) $22,000.
C) $80,000.
D) $88,000.
Answer: A
Explanation: Signal's business income is $400,000 ($900,000 business receipts - $500,000 business deductions; investment income is not included). Serena's share of the business income is $100,000. The qualified business income deduction is 20% of the $100,000.
Page Ref.: I:1-20; Example I:1-16
Objective: 5

19) Which of the following is <u>not</u> an advantage of a limited liability company (LLC)?
A) limited liability for all members of an LLC
B) ability to choose between taxation as a partnership or corporation
C) default tax treatment as a corporation, unless otherwise elected
D) All of the above are advantages of an LLC.
Answer: C
Explanation: A business operated as an LLC is treated as a flow-through entity unless the LLC elects to be taxed as a corporation.
Page Ref.: I:1-22 and I:1-23
Objective: 5

20) What is an important aspect of a limited liability partnership?
A) It is the same as a limited partnership where the general partner has unlimited liability.
B) A partner has unlimited liability arising from his or her own acts of negligence or misconduct or similar acts of any person under his or her direct supervision, but does not have unlimited liability in other matters.
C) All partners have limited liability regarding all partnership activities.
D) All partners have unlimited liability.
Answer: B
Explanation: A partner in an LLP remains responsible for his or her own actions, or those under his supervision, but is not liable for the actions of other partners.
Page Ref.: I:1-23
Objective: 5

21) Brad and Angie had the following income and deductions during 2024:

Salaries	$125,000
Interest income	10,000
Itemized deductions	31,000
Taxes withheld during year	12,000

Calculate Brad and Angie's tax liability due or refund. They file a joint tax return.
Answer:

Salaries	$125,000
Interest income	10,000
Gross income	135,000
Deduction for AGI	0
AGI	135,000
Itemized deductions	(31,000)
Taxable income	$104,000

Tax = $10,852 + .22(104,000 - 94,300) = $12,986
$12,986 - 12,000 taxes withheld = $986 taxes due
Page Ref.: I:1-17 and I:1-18; Example I:1-13
Objective: 5

22) Chris, a single taxpayer, had the following income and deductions during 2024:

Salary	$65,000
Interest on bank account	300
Tax-exempt interest	200
Deduction for AGI	2,500
Itemized deductions	16,000
Taxes withheld	7,500

Calculate Chris's tax liability due or refund.
Answer:

Salary	$65,000
Interest on bank account	300
Gross income	65,300
Deduction for AGI	(2,500)
Adjusted gross income	62,800
Itemized deductions	(16,000)
Taxable income	$46,800

Tax $1,160 + .12(46,800 - 11,600) = 5,384
$7,500 taxes withheld - 5,384 tax = $2,116 tax refund
Page Ref.: I:1-17 and I:1-18; Example I:1-13
Objective: 5

23) During the current tax year, Frank Corporation generated gross income of $1,900,000 and had ordinary and necessary deductions of $1,400,000. What is the amount of Frank Corporation's corporate income tax for the year?
Answer: Taxable income is $1,900,000 - $1,400,000 = $500,000. The tax is $105,000 ($500,000 × .21).
Page Ref.: I:1-19; Example I:1-14
Objective: 5

24) During the current tax year, Charlie Corporation generated gross income of $1,800,000 and had ordinary and necessary deductions of $1,300,000, resulting in taxable income of $500,000. If Charlie Corporation paid qualifying dividends of $200,000 to shareholders, all of whom subject to a 15% marginal tax rate on qualifying dividend income, what is the total tax paid on both corporate income and the corporate dividends?
Answer: Corporate taxable income is $1,800,000 - $1,300,000 = $500,000. Dividends are not tax deductible to the corporation.
Corporate tax: ($500,000 × .21) = $105,000
Shareholder tax on qualifying dividends: $200,000 × .15 maximum rate on qualifying dividends = $30,000
Total Tax: $105,000 + $30,000 = $135,000
Page Ref.: I:1-19 and I:1-20; Example I:1-15
Objective: 5

25) Doug and Frank form a partnership, D and F Advertising, each contributing $50,000 to start the business. During the first year of operations, D and F earns $80,000, which is allocated $40,000 each to Doug and Frank. At the beginning of the second year, Doug sells his interest to Marcus for $90,000. What is the amount of Doug's taxable gain on the sale?
Answer: There is no gain on the sale.

Amount realized	$90,000
Adjusted basis *	-90,000
Gain or loss on sale.	0

*Adjusted basis as of date of sale is the $50,000 contributed basis plus the $40,000 income allocated to basis.
Page Ref.: I:1-21; Example I:1-17
Objective: 5

26) Leonard established a trust for the benefit of his son. The principal amount of the trust is $400,000. The trust is projected to earn approximately 5% per year. In the current year, the trust earned $20,000. Expenses of $4,000 were incurred. Assume that $14,000 is distributed to Leonard's son.
a. How much income is taxed to the trust?
b. How much income is taxed to Leonard's son?
Answer:
a. $20,000 income - $4,000 expenses - $14,000 distribution = $2,000 taxed to trust
b. $14,000 is included in Leonard's son's taxable income for the year.
Page Ref.: I:1-23
Objective: 5

LO6: Tax Law Sources

1) The tax law encompasses administrative and judicial interpretations, such as Treasury regulations, revenue rulings, revenue procedures, and court decisions, as well as statutes.
Answer: TRUE
Explanation: Sources of tax law extend beyond the Internal Revenue Code itself.
Page Ref.: I:1-24
Objective: 6

2) The term "tax law" includes
A) Internal Revenue Code.
B) Treasury Regulations.
C) judicial decisions.
D) All of the above.
Answer: D
Explanation: The Code is a legislative source; the Regulations are an administrative source, and judicial decisions are judicial sources of tax law.
Page Ref.: I:1-24
Objective: 6

3) Which of the following serves as the highest authority for tax research, planning, and compliance activities?
A) Internal Revenue Code
B) Income Tax Regulations
C) Revenue Rulings
D) Revenue Procedures
Answer: A
Explanation: The Internal Revenue Code is the law passed by Congress. The other documents provide guidance in applying the law.
Page Ref.: I:1-24
Objective: 6

4) All of the following are executive (administrative) sources of tax law <u>except</u>
A) Internal Revenue Code.
B) Income Tax Regulations.
C) Revenue Rulings.
D) Revenue Procedures.
Answer: A
Explanation: The Internal Revenue Code is a legislative source.
Page Ref.: I:1-24 and Topic Review I:1-3
Objective: 6

LO7: Enactment of a Tax Law

1) Generally, tax legislation is introduced first in the Senate and referred to the Senate Finance Committee.
Answer: FALSE
Explanation: A tax bill is first introduced in the House and referred to the Ways and Means Committee.
Page Ref.: I:1-24
Objective: 7

2) Which of the following steps, related to a tax bill, occurs first?
A) signature or veto by the President of the United States
B) consideration by the Senate
C) consideration by the House Ways and Means Committee
D) consideration by the Joint Conference Committee
Answer: C
Explanation: Most tax legislation originates in the House of Representatives and is then referred to the House Ways and Means Committee.
Page Ref.: I:1-24
Objective: 7

3) A tax bill introduced in the House of Representatives is then
A) referred to the House Ways and Means Committee for hearings and approval.
B) referred to the full House for hearings.
C) forwarded to the Senate Finance Committee for consideration.
D) voted upon by the full House.
Answer: A
Explanation: Most tax legislation originates in the House of Representatives and is then referred to the House Ways and Means Committee.
Page Ref.: I:1-24
Objective: 7

4) When new tax legislation is being considered by Congress
A) the tax bill will usually originate in the Senate.
B) different versions of the House and Senate bills are reconciled by the Speaker of the House and the President of the Senate.
C) different versions of the House and Senate bills are reconciled by a Joint Conference Committee.
D) after the President of the United States approves a tax bill, the Joint Conference Committee must then vote on passage of the bill.
Answer: C
Explanation: The Joint Conference Committee reconciles the House and Senate bills.
Page Ref.: I:1-25
Objective: 7

5) The Senate equivalent of the House Ways and Means Committee is the Senate
A) Joint Committee on Taxation.
B) Ways and Means Committee.
C) Finance Committee.
D) Joint Conference Committee.
Answer: C
Explanation: The Senate Finance Committee considers tax legislation.
Page Ref.: I:1-25
Objective: 7

6) List the steps in the legislative process for major tax reform.
Answer:
1. Tax bill is introduced by member(s) of House of Representatives and referred to House Ways and Means Committee.
2. House Ways and Means Committee considers and studies House bill.
3. House Ways and Means Committee votes and approved bill is forwarded to full House.
4. Approval of House bill by the House of Representatives.
5. Senate Finance Committee modifies and amends House bill into separate Senate bill.
6. Approval of Senate bill by the Senate.
7. Both bills sent to Joint Conference Committee.
8. Reconciled bill issued by a Joint Conference Committee and sent to House and Senate for approval.
9. Approval or veto of legislation by the President.
10. New tax law and amendments incorporated into the Code.
Page Ref.: I:1-24 and I:1-25; Table I:1-2
Objective: 7

LO8: Administration of the Tax Law and Tax Practice Issues

1) The Internal Revenue Service is the branch of the Treasury Department responsible for administering the federal tax law.
Answer: TRUE
Explanation: The IRS is the branch of the Treasury Department that is responsible for administration of the Internal Revenue Code.
Page Ref.: I:1-26
Objective: 8

2) Generally, the statute of limitations is three years from the later of the date the tax return is filed or the due date.
Answer: TRUE
Explanation: While there are exceptions that extend the statute of limitations, the general limit is three years from the later of the filing date or the due date of a return.
Page Ref.: I:1-28
Objective: 8

3) When returns are processed, they are scored to determine their potential for yielding additional tax revenues. This program is called
A) Taxpayer Compliance Measurement Program.
B) Discriminant Function System.
C) Standard Audit Program.
D) Field Audit Program.
Answer: B
Explanation: The scoring system of risk measurement by the IRS is called the Discriminant Function System.
Page Ref.: I:1-27
Objective: 8

4) Which of the following individuals is most likely to be audited?
A) Lola has AGI of $35,000 from wages and uses the standard deduction.
B) Marvella has a $145,000 net loss from her unincorporated business (a horse farm). She also received $950,000 salary as a CEO of a corporation.
C) Melvin is retired and receives Social Security benefits.
D) Jerry is a school teacher with two children earning $55,000 a year. He also receives $200 in interest income on a bank account.
Answer: B
Explanation: Of those listed, the taxpayer with investments or trade or business expenses that produce significant losses, Marvella, is most likely to be audited.
Page Ref.: I:1-27
Objective: 8

5) Alan filed his 2023 tax return on April 1, 2024, shortly before the April 15 due date. His return contains no misstatements or omissions of income. The statute of limitations for changes to the return expires
A) April 1, 2027.
B) April 15, 2027.
C) April 15, 2028.
D) The statute of limitations never expires.
Answer: B
Explanation: The three-year statute applies, beginning with the April 15 due date of the return.
Page Ref.: I:1-28
Objective: 8

6) Peyton has adjusted gross income of $2,000,000 on his 2023 tax return, filed April 15, 2024, the due date. He accidentally failed to include $200,000 that he received for a television advertisement. How long does the IRS have to audit Peyton's federal tax return?
A) until April 15, 2026
B) until April 15, 2027
C) until April 15, 2030
D) The IRS can audit Peyton's return at any future date.
Answer: B
Explanation: The omission does not exceed 25% of reported gross income, so the three-year statute still applies. Since the omission was accidental, the rules for fraud do not apply.
Page Ref.: I:1-28
Objective: 8

7) Latashia reports $100,000 of gross income on her 2023 tax return, filed on the April 15, 2024 due date. She omits $30,000 of income, but the error was not fraudulent. When does the statute of limitations for examining her tax return expire?
A) April 15, 2026
B) April 15, 2027
C) April 15, 2030
D) It never expires.
Answer: C
Explanation: The six-year statute applies since the omitted income exceeds 25% of the gross income reported.
Page Ref.: I:1-28
Objective: 8

8) The IRS must pay interest on
A) all tax refunds.
B) tax refunds paid later than 30 days after the due date.
C) tax refunds paid later than 45 days after the due date.
D) The IRS never pays interest on tax refunds.
Answer: C
Explanation: The IRS does not have to pay interest if the refund is paid within 45 days after the due date (or filing date, if later).
Page Ref.: I:1-28; Example I:1-27
Objective: 8

9) Kate files her tax return 36 days after the due date. When she files the return, she sends a check for $2,000 which is the balance of the tax owed by her. Kate's penalty for failure to file a return will be
A) 0.5% per month (or factor thereof) up to a maximum of 25%.
B) 5% per month (or factor thereof) up to a maximum of 25%.
C) 20% per month (or factor thereof).
D) 25%.
Answer: B
Explanation: The penalty for failure to file is 5% per month up to 25%.
Page Ref.: I:1-28
Objective: 8

10) What are the correct monthly rates for calculating failure to file and failure to pay penalties?
A)

Failure to file	Failure to pay
5.0%	5.0%

B)

Failure to file	Failure to pay
0.5%	0.5%

C)

Failure to file	Failure to pay
5.0%	0.5%

D)

Failure to file	Failure to pay
0.5%	5.0%

Answer: C
Explanation: The penalty for failure to file is 5% per month up to 25%. The failure to pay penalty is 0.5% per month up to 25%.
Page Ref.: I:1-28 and I:1-29
Objective: 8

11) Frederick failed to file his 2024 tax return on a timely basis. In fact, he filed his 2024 income tax return on October 31, 2025 and paid the amount due at that time. He failed to make timely extensions. Below are amounts from his 2024 return:

Taxable income	$120,000
Total tax liability on taxable income	22,200
Total tax withheld from his salary	22,000

Frederick sent a check for $200 in payment of his liability. He thinks that he has met all of his financial obligations to the government for 2024. Given a due date of April 15, 2025, what additional amounts may Frederick be liable for assuming any applicable interest rate is 6%?
Answer: Since Frederick's return is filed late and the final balance due on the return is paid late, Frederick is subject to further interest and penalties on his 2024 income tax return. Both interest and penalties are computed on the net tax due.

There are two penalties to which Frederick would be subject, a failure to file (timely) penalty and a failure to pay the tax (timely) penalty. The late payment penalty is .5% per month to a maximum of 25%; the late filing penalty is 5% per month to a maximum of 25%. However, both penalties are not assessed together. The taxpayer will be assessed the maximum combined 25% penalty imposed on the $200 additional tax due, or $50. In addition, the IRS will assess interest.
Page Ref.: I:1-28 and I:1-29
Objective: 8

12) Explain how returns are selected for audit.
Answer: The IRS uses both computers and experienced personnel to select returns for examination. The Discriminant Function System (DIF) is used to select returns for examination. The DIF system generates a score for a return based on the potential for the return to generate additional tax revenue. After returns are scored based on the DIF system, the returns are manually screened by experienced IRS personnel who decide which returns warrant further examination.
Page Ref.: I:1-27
Objective: 8

13) Describe the types of audits that the IRS conducts.
Answer: In an office audit, the taxpayer goes to the IRS office and brings substantiation for a particular deduction, credit or income item. An office audit does not involve a complete audit for all items on the return. A field audit is used for corporations engaged in a trade or business. A field audit generally is broader in scope than an office audit. A field audit usually is conducted at the taxpayer's place of business or the office of his or her tax advisor. Most large corporations are subject to annual audits.
Page Ref.: I:1-27
Objective: 8

14) What does the statute of limitations mean? Describe the different statutes of limitations that apply to tax returns.
Answer: The statute of limitations is the period of time in which the taxpayer and/or the IRS can revise a tax return. Typically the statute of limitations is three years from the later of the filing date or due date of the return. If 25% or more of income is omitted from the return, the statute of limitations is six years from the later of the date filed or return's due date. For a return that has not been filed or involves fraud, the statute of limitations is never closed.
Page Ref.: I:1-28
Objective: 8

15) Describe the nondeductible penalties imposed upon taxpayers for failure to comply.
Answer:
a. A penalty of 5% per month subject to a maximum of 25% is imposed for failure to file a tax return.
b. A penalty of 0.5% per month subject to a maximum of 25% is imposed for failure to pay a tax that is due.
c. An accuracy related penalty of 20% for underpayment due to negligence or disregard of the rules or regulations.
d. A 75% penalty is imposed for fraud.
e. A penalty based upon the current interest rate is imposed for underpayment of estimated taxes.
Page Ref.: I:1-28 and I:1-29
Objective: 8

LO9: Components of a Tax Practice

1) Which is not a component of tax practice?
A) providing clients tax refund advance loans
B) tax research
C) tax planning and consulting
D) compliance
Answer: A
Explanation: Tax research, tax planning and consulting and tax compliance are all regular aspects of tax practice. Providing tax refund loans is not acceptable practice.
Page Ref.: I:1-29
Objective: 9

2) Describe the components of tax practice.
Answer:
a. Tax compliance and procedure.
b. Tax research.
c. Tax planning and consulting.
d. Financial planning.
Page Ref.: I:1-29
Objective: 9

L10: Computer Applications in Tax Practice

1) The computer is the primary tool of the tax professional. The tax professional uses the computer for all of the following client services except
A) tax planning for clients.
B) tax research for client questions.
C) investment purchases on behalf of clients.
D) tax return preparation.
Answer: C
Explanation: Tax planning, tax research and tax return preparation are routine services by tax professionals on behalf of their clients utilizing software. Making investments is not.
Page Ref.: I:1-31 and I:1-32
Objective: 10