Fundamentals of Taxation 2025 Edition 1st edition Cruz Solutions Manual

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CHAPTER 1 – SOLUTIONS
END OF CHAPTER MATERIAL

Discussion Questions

1. (Introduction) Give a brief history of the income tax in the United States.

Answer:

The first federal income tax was enacted in 1861 to help finance the Civil War and was discarded soon thereafter. In 1894, another income tax was promulgated by Congress to raise additional tax revenue and to expand the sources of revenue. In 1895, the Supreme Court ruled that the federal income tax was unconstitutional. In 1913, the sixteenth Amendment to the U.S. Constitution was enacted. This amendment gave Congress the power to levy and collect taxes. In 2022, the federal government collected about $2.28 trillion in individual income taxes.

Feedback:
Learning Objective: 01-01
Topic: Tax Rate Structures
Difficulty: 1 Easy
EA: No

2. (Introduction) For fiscal year 2023, what proportion of individual income tax returns was electronically filed?

Answer:

In fiscal year 2023, electronically filed tax returns were about 90.7% of total returns.

Feedback: Calculated from Table 1-1
Learning Objective: 01-01
Topic: Tax Rate Structures
Difficulty: 2 Medium
EA: No

3. Name the three types of tax rate structures and give an example of each.

Answer:

Progressive — U.S. federal income tax
Proportional — "flat-tax" usually levied on property or sales at the state or local level
Regressive — Social Security tax

Feedback:
Learning Objective: 01-01
Topic: Tax Rate Structures
Difficulty: 1 Easy

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EA: No

4. What is a *progressive tax*? Why do you think the government believes it is a more equitable tax than, say, a regressive tax or proportional tax?

Answer:

A progressive rate structure is a structure where the tax rate increases as the tax base increases. The progressive rate structure is viewed as more equitable because the amount of tax paid varies with the ability to pay. For example, the government believes that as an individual makes more income, a smaller percentage of that income is needed to buy necessary living supplies and thus more income is available to pay taxes.

Feedback:
Learning Objective: 01-01
Topic: Tax Rate Structures
Difficulty: 2 Medium
EA: No

5. What type of tax is a sales tax? Explain your answer.

Answer:

The sales tax is a proportional tax. A proportional tax is a tax where the tax rate remains the same regardless of the tax base. Most county or state sales tax rates are the same regardless of the amount of sales upon which the tax is levied. With a proportional tax, the marginal tax rate and average tax rate are always the same.

Feedback:
Learning Objective: 01-01
Topic: Tax Rate Structures
Difficulty: 1 Easy
EA: No

6. What is the definition of *tax base,* and how does it affect the amount of tax levied?

Answer:

The tax base is the dollar amount upon which the tax rate is applied in order to determine the actual tax. Income, dollar sales, and property value are the more common tax bases in the United States.

Feedback:
Learning Objective: 01-01
Topic: Tax Rate Structures
Difficulty: 1 Easy
EA: No

7. What type of tax rate structure is the U.S. federal income tax? Explain your answer.

Answer:

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The federal income tax is a progressive tax. As the tax base increases, the rate of tax increases. Tax rates range from a low of 10% to a high of 37%.
Feedback:
Learning Objective: 01-01
Topic: Tax Rate Structures
Difficulty: 1 Easy
EA: No

8. A change to a 17% flat tax could cause a considerable increase in many taxpayers' taxes and a considerable decrease in the case of others. Explain this statement in light of the statistics in Table 1-3.

Answer:
Those with taxable income above $200,000 have average tax rates greater than 17%, those with taxable income below $200,000 have average tax rates less than 17%. Thus, on average, if a 17% flat tax were enacted, those with taxable income under $200,000 would see their tax liability go up, and those with taxable income over $200,000 would have lower tax liability.
Feedback: Based on the average tax rates in Table 1-3
Learning Objective: 01-01
Topic: Tax Rate Structures
Difficulty: 2 Medium
EA: No

9. Explain what is meant by *regressive tax*. Why is the Social Security tax considered a regressive tax?

Answer:
A regressive tax rate is one where the tax rate decreases as the tax base gets larger. The Social Security tax is assessed on the first $168,600 of wages (in 2024). Thus, the Social Security tax rate is 6.2% (12.4% if self-employed) on the first $168,600 of wages and 0% on wages above $168,600.
Feedback:
Learning Objective: 01-01
Topic: Tax Rate Structures
Difficulty: 1 Easy
EA: No

10. Define and compare these terms: *average tax rate* and *marginal tax rate.*

Answer:
The average tax rate is the total tax liability divided by the taxable income (or tax base). The marginal tax rate is the tax rate applied to the last dollar (or, more accurately, the *next* dollar) of taxable income. In a progressive rate structure, the average tax rate is always the same as or is lower than the marginal tax rate.
Feedback:

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Learning Objective: 01-02
Topic: Average tax rate
Topic: Marginal Tax Rates and Average Tax Rates
Difficulty: 1 Easy
EA: No

11. What is meant by *compensation for services*? Give some examples.

Answer:
Compensation for services is the broad category used by the IRS to encompass all forms of economic benefit a taxpayer may receive because of an employee/employer arrangement. Examples are: wages, salaries, tips, sick pay, bonuses, fringe benefits, commissions, etc.
Feedback:
Learning Objective: 01-03
Topic: The Components of a Basic Form 1040
Difficulty: 1 Easy
EA: Yes

12. What is the definition of *interest*?

Answer:
Interest is compensation for the "use of money" with respect to a bona fide debt or obligation imposed by law (e.g., judgments, loans, installment sales).
Feedback:
Learning Objective: 01-03
Topic: The Components of a Basic Form 1040
Difficulty: 1 Easy
EA: Yes

13. What federal tax forms do taxpayers normally receive to inform them of the amount of wages and interest they earned during the year?

Answer:
Normally, wages are reported to taxpayers on a W-2 form, and interest is reported on a Form 1099-INT.
Feedback:
Learning Objective: 01-03
Topic: The Components of a Basic Form 1040
Difficulty: 1 Easy
EA: Yes

14. Explain why unemployment compensation is taxable.

Answer:
Unemployment compensation is paid to an individual as a result of that person becoming unemployed. The compensation is, in effect, a substitute for taxable wages. Thus, it is taxable just as wages are taxable.

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Feedback:
Learning Objective: 01-03
Topic: The Components of a Basic Form 1040
Difficulty: 1 Easy
EA: Yes

15. What is the amount of the standard deduction for single and married taxpayers who use Form 1040?

Answer:
On Form 1040, taxpayers can take a permitted deduction on line 12 of $14,600 if the taxpayer's filing status is single or $29,200 if their filing status is married filing jointly.
Feedback:
Learning Objective: 01-03
Topic: The Components of a Basic Form 1040
Difficulty: 1 Easy
EA: Yes

16. What is the most common way taxpayers pay their income tax liability during the year?

Answer:
The vast majority of taxpayers pay their annual tax liability through income tax withholding deducted from their paychecks by their employer and remitted to the government on behalf of the taxpayer.
Feedback:
Learning Objective: 01-03
Learning Objective: 01-04
Topic: The Components of a Basic Form 1040
Topic: Calculation of Income Tax
Difficulty: 1 Easy
EA: No

Multiple Choice

17. A tax rate that decreases as the tax base increases is an example of what kind of tax rate structure?
    a. Progressive.
    b. Proportional.
    c. Regressive.
    d. Recessive.

Answer: c.
Feedback:
Learning Objective: 01-01

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Topic: Tax Rate Structures
Difficulty: 1 Easy
EA: No

18. A tax rate that decreases as the tax base decreases is an example of what kind of tax rate structure?
    a. Progressive.
    b. Proportional.
    c. Regressive.
    d. Recessive.

Answer: a.
Feedback:
Learning Objective: 01-01
Topic: Tax Rate Structures
Difficulty: 1 Easy
EA: No

19. Jake had taxable income of $40,000 and paid $1,500 of income tax; Jill had taxable income of $15,000 and paid $4,000 of income tax. The tax rate structure they are subject to is:
    a. Progressive.
    b. Proportional.
    c. Regressive.
    d. Recessive.

Answer: c.
Feedback: $1,500 ÷ $40,000 = 3.75% average rate for Jake. $4,000 ÷ $15,000 = 26% average rate for Jill. Jill has lower income and a higher tax rate compared to Jake, so the tax structure is regressive.
Learning Objective: 01-01
Topic: Tax Rate Structures
Difficulty: 2 Medium
EA: No

20. Margaret earned $15,000 and paid $3,000 of income tax; Marshawn earned $50,000 and paid $10,000 of income tax. The tax rate structure they are subject to is:
    a. Progressive.
    b. Proportional.
    c. Regressive.
    d. Recessive.

Answer: b.
Feedback: $3,000 ÷ $15,000 = 20% average rate for Margaret. $10,000 ÷ $50,000 = 20% average rate for Marshawn. Both had the same average rate with differing amounts of income, so the tax rate structure is proportional.
Learning Objective: 01-01

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Topic: Tax Rate Structures
Difficulty: 2 Medium
EA: No

21. Which of the following is an example of a regressive tax?
    a. Federal income tax.
    b. State and local taxes levied on property.
    c. Sales tax.
    d. Social Security tax.

Answer: d.
Feedback:
Learning Objective: 01-01
Topic: Tax Rate Structures
Difficulty: 2 Medium
EA: No

22. Which of the following is an example of a progressive tax?
    a. Federal income tax.
    b. State and local taxes levied on property.
    c. Sales tax.
    d. Social Security tax.

Answer: a.
Feedback:
Learning Objective: 01-01
Topic: Tax Rate Structures
Difficulty: 2 Medium
EA: No

23. Hector, a single taxpayer, has taxable income of $98,975 and the following tax liability:

$11,600 × 10% =	$ 1,160.00
($47,150 − $11,600) × 12% =	4,266.00
($98,975 − $47,150) × 22% =	11,401.50
Total tax liability	$16,827.50

The marginal tax rate is:

    a. 10%.
    b. 12%.
    c. 17%
    d. 22%.

Answer: d.
Feedback: Marginal rate is the rate on the last dollar of income, which is 22% in this case.
Learning Objective: 01-02

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Topic: Marginal Tax Rates and Average Tax Rates
Difficulty: 2 Medium
EA: No

24. Hector, a single taxpayer, has taxable income of $98,975 and the following tax liability:

$11,600 × 10% =	$ 1,160.00
($47,150 − $11,600) × 12% =	4,266.00
($98,975 − $47,150) × 22% =	11,401.50
Total tax liability	$16,827.50

The average tax rate is:

a. 10%.
b. 12%.
c. 17%.
d. 22%.

Answer: c.
Feedback: $16,827.50 ÷ $98,975 = 17%
Learning Objective: 01-02
Topic: Marginal Tax Rates and Average Tax Rates
Difficulty: 2 Medium
EA: No

25. Which of the following is not a permitted filing status?

a. Married filing jointly.
b. Single filing jointly.
c. Head of household.
d. Qualifying widow.

Answer: b.
Learning Objective: 01-03
Topic: The Components of a Basic Form 1040
Difficulty: 1 Easy
EA: Yes

26. Individual taxpayers with only wage income must file a Form:

a. 1040.
b. 1040W.
c. 1099W.
d. W-2.

Answer: a.

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Learning Objective: 01-03
Topic: The Components of a Basic Form 1040
Difficulty: 1 Easy
EA: Yes

27. Wage income is reported to a taxpayer on a Form:
    a. W-2.
    b. 1099-G.
    c. 1099-W.
    d. 1099-INT.

Answer: a.
Learning Objective: 01-03
Topic: The Components of a Basic Form 1040
Difficulty: 1 Easy
EA: Yes

28. Interest income is reported to a taxpayer on a Form:
    a. W-2.
    b. W-2-INT.
    c. 1099-G.
    d. 1099-INT.

Answer: d.
Learning Objective: 01-03
Topic: The Components of a Basic Form 1040
Difficulty: 1 Easy
EA: Yes

29. On a Form 1040, the amount of the permitted deduction from income for taxpayers filing a joint return is:
    a. $1,500.
    b. $14,600.
    c. $21,900.
    d. $29,200.

Answer: d.
Learning Objective: 01-03
Topic: The Components of a Basic Form 1040
Difficulty: 1 Easy
EA: Yes

30. Tawanda determined that her tax liability was $2,748. Her employer withheld $2,491 from her paychecks during the year. Tawanda's tax return would show:
    a. a refund of $257.
    b. a refund of $2,491.
    c. tax due of $257.

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d. tax due of $2,748.

Answer: c.
Feedback: $2,748 liability – $2,491 withholding = $257 tax due.
Learning Objective: 01-03
Topic: The Components of a Basic Form 1040
Difficulty: 2 Medium
EA: Yes

31. Sandra, a single taxpayer, has taxable income of $81,498. Using the tax tables, she has determined that her tax liability is:
    a. $12,983.
    b. $12,978.
    c. $11,284.
    d. $9,313.

Answer: b.
Feedback:
Learning Objective: 01-04
Topic: Calculation of Income Tax
Difficulty: 2 Medium
EA: Yes

32. A married taxpayer has taxable income of $54,268. You have calculated tax liability using the tax tables and using the tax rate schedules. What can you say about the two figures?
    a. Tax liability determined using the tax tables will be more than tax liability determined using the tax rate schedules.
    b. Tax liability determined using the tax tables will be less than tax liability determined using the tax rate schedules.
    c. Tax liability determined using the tax tables will be the same as tax liability determined using the tax rate schedules.
    d. The answer cannot be determined with the information provided.

Answer: a.
Feedback: The tax rate schedules determine tax using a precise taxable amount of $54,268. The tax tables are based on a midpoint amount of $54,275 (the midpoint of the $54,250 to $54,300 range). In this case, the tax tables calculation is based on a slightly larger taxable income, thus the tax liability will be slightly larger as well.
Learning Objective: 01-04
Topic: Calculation of Income Tax
Difficulty: 3 Hard
EA: No

33. Eddie, a single taxpayer, has W-2 income of $40,841. Using the tax tables, he has determined that his tax liability is:
    a. $4,667.

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b. $4,335.
c. $2,915.
d. some other number.

Answer: c.
Feedback: Subtract the $14,600 standard deduction from W-2 income to get taxable income which is used for the tax tables.
Learning Objective: 01-03
Learning Objective: 01-04
Topic: Tax Return Components
Topic: Calculation of Income Tax
Topic: Tax Payments
Difficulty: 3 Hard
EA: Yes

34. Arno and Bridgette are married, file a joint return, and have combined W-2 income of $76,440. They paid additional tax of $418 when they filed their taxes. How much income tax did their employers withhold during the year?
    a. $4,785.
    b. $5,203.
    c. $5,621.
    d. The answer cannot be determined with the information provided.

Answer: a.
Feedback: Subtract $29,200 permitted deduction from W-2 income to get taxable income which is used for the tax tables. After determining total tax liability of $5,203, subtract the $418 additional tax to get withholding.
Learning Objective: 01-03
Learning Objective: 01-04
Topic: Tax Payments
Topic: Calculation of Income Tax
Difficulty: 3 Hard
EA: Yes

Problems

35. Using the information in Table 1-3, determine the average amount of taxable income per tax return, rounded to the nearest dollar, for each of the ranges of taxable income provided.

Answer:

Under $15,000 = $3,591,780,000 ÷ 29,392,477 = $122
$15,000 to under $30,000 = $159,503,527,000 ÷ 24,863,933 = $6,415
$30,000 to under $50,000 = $633,503,116,000 ÷ 28,847,954 = $21,960
$50,000 to under $100,000 = $1,991,655,307,000 ÷ 39,111,531 = $50,922
$100,000 to under $200,000 = $2,897,084,792,000 ÷ 25,982,949 = $111,499
$200,000 or more = $6,269,183,959,000 ÷ 12,529,286 = $500,362

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Feedback: In each case, the average taxable income per return is calculated by dividing total taxable income by the number of tax returns. Remember that the taxable income is shown in thousands, so you need to add three zeros to the taxable income number provided.
Learning Objective: 01-01
Topic: Tax Rate Structures
Difficulty: 2 Medium
EA: No

36. Using the information in Table 1-3, determine the amount of average income tax liability per tax return, rounded to the nearest dollar, for each income range provided.

Answer:

Under $15,000 = $374,588,000 ÷ 29,392,477 = $13
$15,000 to under $30,000 = $16,089,345,000 ÷ 24,863,933 = $647
$30,000 to under $50,000 = $58,363,691,000 ÷ 28,847,954 = $2,023
$50,000 to under $100,000 = $231,523,584,000 ÷ 39,111,531 = $5,920
$100,000 to under $200,000 = $420,525,310,000 ÷ 25,982,949 = $16,185
$200,000 or more = $1,555,183,998,000 ÷ 12,529,286 = $124,124

Feedback: In each case, the average tax liability per return is calculated by dividing the total tax liability by the number of tax returns. Remember that the total tax liability is shown in thousands, so you need to add three zeros to the tax liability number provided.
Learning Objective: 01-01
Topic: Tax Rate Structures
Difficulty: 2 Medium
EA: No

37. Use the information in Table 1-3. If the federal tax system was changed to a proportional tax rate structure with a tax rate of 17%, calculate the amount of tax liability for 2022 for all taxpayers. How does this amount differ from the actual liability?

Answer:

The tax liability assuming a 17% flat rate can be calculated by adding up the taxable income for all income ranges and multiplying it by 17%.

Total taxable income:

$	**3,591,780,000**
	159,503,527,000
	633,503,116,000
	1,991,655,307,000
	2,897,084,792,000
	6,269,183,959,000

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$11,954,522,481,000
× .17

$2,032,268,821,770 tax liability for all taxpayers, assuming 17% rate.
==========

Compare that number with the total tax liability on Table 1-3:

$ 374,588,000
16,089,345,000
58,363,691,000
231,523,584,000
420,525,310,000
1,555,183,998,000

$ 2,282,060,516,000
==========

A 17% flat tax would raise about $2.032 trillion of tax revenue compared to almost $2.282 trillion of tax revenue under current tax law. Thus, instituting a 17% flat tax on the same tax base would raise about $250 billion less than current law.

Further, the distribution of tax liability would be significantly different across the income ranges presented. On average, those with adjusted gross income of $200,000 or more would pay less with a 17% flat tax, and those with adjusted gross income less than $200,000 would pay more. In effect, the 17% benchmark would make about 12.5 million taxpayers better off and 148.2 million taxpayers worse off.

Feedback:
Learning Objective: 01-01
Topic: Tax Rate Structures
Difficulty: 3 Hard
EA: No

38. What is the income tax formula in simplified form?

Answer:

The income tax formula is the methodology used to determine the amount of tax owed by a taxpayer. In its most simplified form, the income tax formula is:

Income
− Permitted deductions from income

= Taxable income
× Appropriate tax rates

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= Tax liability
− Tax payments and tax credits

= Tax refund or tax due with return

Feedback: From page 1-5
Learning Objective: 01-02
Topic: A Simple Income Tax Formula
Difficulty: 1 Easy
EA: Yes

39. What are the five filing statuses that are permitted on a Form 1040?

Answer:

The five filing statuses permitted on a Form 1040 are: single, married filing jointly, married filing separately, head of household, and qualifying widow(er).

Feedback: From page 1-6
Learning Objective: 01-03
Topic: The Components of a Basic Form 1040
Difficulty: 1 Easy
EA: Yes

40. When taxpayers file a tax return, they will either pay an additional amount or receive a refund of excess taxes paid. Briefly explain how this "settling up" process works. Why might a taxpayer pay too much during the year?

Answer:

When a tax return is filed, the taxpayer determines the total amount of tax liability. Normally, during the year, taxpayers pay this liability to the government through income tax withholdings. These withholdings (or other payments) are an estimate of the total tax liability that will be due at the end of the year. There will almost always be a difference between the actual amount due and the amount estimated. The amount due or overpaid is determined when the final tax return is filed.

A taxpayer will pay too much during the year if they estimate a higher tax liability than is actually due. Sometimes taxpayers choose to pay "too much" as a method of forced savings.

Learning Objective: 01-03
Topic: Tax Payments
Difficulty: 2 Medium
EA: Yes

41. Miremba is single and has taxable income of $74,541. For that income, determine tax liability using the tax tables and using the tax rate schedule. Why is there a difference between the two amounts?

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Answer:

Miremba's tax using the tax tables is $11,449. Tax using the tax rate schedules is $11,452.02.

There is a $3.02 difference between the two amounts because the tax tables are based on taxable income at the midpoint of the range between $74,500 and $74,550, while the tax rate schedules are precise. Thus, the tax tables are based on a taxable income of $74,525, and the tax rate schedules are based on taxable income of $74,541.

Learning Objective: 01-04
Topic: Calculation of Income Tax
Difficulty: 3 Hard
EA: Yes

42. Havel and Petra are married and will file a joint tax return. Havel has W-2 income of $42,790, and Petra has W-2 income of $49,144. What is their tax liability? Determine their tax liability using both the tax tables and the tax rate schedule.

Answer:

Their tax liability using the tax tables is $7,063, and their liability using the tax rate schedules is $7,064.08.

Feedback: Note that their taxable income is $62,734. Remember that you need to subtract the permitted deduction of $29,200 from their W-2 wages to obtain taxable income.
Learning Objective: 01-04
Topic: Calculation of Income Tax
Difficulty: 3 Hard
EA: Yes

43. Determine the tax liability, marginal tax rate, and average tax rate (rounded to two decimal places) in each of the following cases. Use the tax tables to determine tax liability.
    a. Single taxpayer, taxable income of $30,916.
    b. Single taxpayer, taxable income of $92,197.

Answer:

a. Liability = $3,479 marginal = 12% average = 11.25%
b. Liability = $15,332 marginal = 22% average = 16.63%

Feedback: Liability comes from the tax tables. Marginal rate is the rate on the last dollar of income according to the tax rate schedules. Average rate is the tax liability divided by the taxable income.
Learning Objective: 01-02
Learning Objective: 01-04
Topic: Marginal Tax Rates and Average Tax Rates
Topic: Calculation of Income Tax
Difficulty: 3 Hard

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EA: Yes

44. Determine the tax liability, marginal tax rate, and average tax rate (rounded to two decimal places) in each of the following cases. Use the tax tables to determine tax liability.
    a. Married taxpayers, taxable income of $92,197.
    b. Married taxpayers, taxable income of $76,312.

Answer:

a. Liability = $10,597 marginal = 12% average = 11.49%
b. Liability = $8,695 marginal = 12% average = 11.39%

Feedback: Liability comes from the tax tables. Marginal rate is the rate on the last dollar of income according to the tax rate schedules. Average rate is the tax liability divided by the taxable income.
Learning Objective: 01-02
Learning Objective: 01-04
Topic: Marginal Tax Rates and Average Tax Rates
Topic: Calculation of Income Tax
Difficulty: 3 Hard
EA: Yes

45. Determine the tax liability, marginal tax rate, and average tax rate (rounded to two decimal places) in each of the following cases. Use the tax tables to determine tax liability.
    a. Married taxpayers, taxable income of $30,916.
    b. Single taxpayer, taxable income of $76,312.

Answer:

a. Liability = $3,247 marginal = 12% average = 10.50%
b. Liability = $11,845 marginal = 22% average = 15.52%

Feedback: Liability comes from the tax tables. Marginal rate is the rate on the last dollar of income according to the tax rate schedules. Average rate is the tax liability divided by the taxable income.
Learning Objective: 01-02
Learning Objective: 01-04
Topic: Marginal Tax Rates and Average Tax Rates
Topic: Calculation of Income Tax
Difficulty: 3 Hard
EA: Yes

46. Use the tax rate schedules to determine tax liability for each of the cases in problems 43, 44, and 45.

Answer:

Liability for 43a = $3,477.92 Liability for 43b = $15,336.34
Liability for 44a = $10,599.64 Liability for 44b = $8,693.44
Liability for 45a = $3,245.92 Liability for 45b = $11,841.64

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Learning Objective: 01-04
Topic: Calculation of Income Tax
Difficulty: 3 Hard
EA: Yes

47. The W-2 income of Sandra, a single taxpayer, was $75,771. Using the tax tables, determine Sandra's tax liability.

Answer:
Sandra's tax liability is $8,512.
Feedback: The problem gives you Sandra's W-2 income. To determine taxable income (the number necessary to use the tax tables), you need to subtract the permitted deduction of $14,600. Sandra's taxable income is $61,171.
Learning Objective: 01-03
Learning Objective: 01-04
Topic: Tax Payments
Topic: Calculation of Income Tax
Difficulty: 3 Hard
EA: Yes

48. The W-2 incomes of Betty and her husband Ronald were $46,936 and $50,378, respectively. If Betty and Ronald use a filing status of married filing jointly, determine their tax liability using the tax tables.

Answer:
Their tax liability is $7,711.
Feedback: The problem gives you Betty and Ronald's W-2 income. To determine taxable income (the number necessary to use the tax tables), you need to subtract the permitted deduction of $29,200. Their taxable income is $68,114
Learning Objective: 01-03
Learning Objective: 01-04
Topic: Tax Payments
Topic: Calculation of Income Tax
Difficulty: 3 Hard
EA: Yes

49. Sheniqua, a single taxpayer, had taxable income of $80,628. Her employer withheld $12,957 in federal income tax from her paychecks throughout the year. Using the tax tables, would Sheniqua receive a refund or would she be required to pay additional tax? What is the amount?

Answer:
$166 refund. Sheniqua's tax liability is $12,791. Her employer withheld $12,957 from her paychecks. Sheniqua has overpaid by $166 ($12,957 – $12,791), so she will receive a refund of that amount.
Feedback:
Learning Objective: 01-03

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Learning Objective: 01-04
Topic: Tax Payments
Topic: Calculation of Income Tax
Difficulty: 3 Hard
EA: Yes

50. Xavier and his wife Maria have total W-2 income of $98,656. They will file their tax return married filing jointly. They had a total of $7,722 withheld from their paychecks for federal income tax purposes. Using the tax tables, determine the amount of refund or additional tax due upon filing their tax return. Indicate whether the amount is a refund or additional tax.

Answer:

$151 additional tax. The problem gives you Xavier and Maria's W-2 income, not their taxable income. To determine taxable income (the number necessary to use the tax tables), you need to subtract the permitted deduction of $29,200. Their taxable income is $69,456, giving them a tax liability of $7,873. They have underpaid by $151 ($7,873 – $7,722), so they must pay additional tax of that amount when they file their tax return.

Learning Objective: 01-03
Learning Objective: 01-04
Topic: Tax Payments
Topic: Calculation of Income Tax
Difficulty: 3 Hard
EA: Yes

Questions Pertaining to Appendix A

51. Discuss the concept of "tax authority." How does tax authority help taxpayers and tax preparers report tax items properly?

Answer:

Tax authority represents the body of law, regulations, judicial decisions, and other items that provide taxpayers and tax professionals with guidance to correctly report taxable income.

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 1 Easy
EA: No

52. What are the three types of tax authority? Who issues each type?

Answer:

Statutory Authority — issued by Congress
Administrative Authority — issued by the IRS
Judicial Authority — issued by the various courts in the U.S. judicial system

Learning Objective: 01-05

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Topic: Tax Authority
Difficulty: 1 Easy
EA: No

53. Discuss the concept of statutory tax authority. Why is there a need for additional types of authority when statutory authority is the law?

Answer:

The most common statutory tax authority is the Internal Revenue Code (IRC). The IRC is written by Congress and is considered the tax law. Other types of authority are necessary because statutory authority is often broad and lacks the detail to answer questions concerning the proper reporting of many different tax transactions. The administrative and judicial authorities (the IRS and the courts) provide interpretations of Congressional intent.

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 2 Medium
EA: No

54. What is the legislative process concerning tax laws? Where does tax legislation often begin?

Answer:

The legislative process is shown in Table 1-4. Tax legislation usually begins in the Ways and Means Committee of the House of Representatives.

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 1 Easy
EA: No

55. What are committee reports, and how can they help the taxpayer or tax preparer?

Answer:

When a tax bill is discussed and voted on by the various congressional committees (Ways and Means, Senate Finance Committee, Joint Conference Committee), a report is produced for that committee. The committee reports set forth the "intent of Congress" as the tax legislation is written. The committee reports are especially useful to taxpayers and professionals because they provide guidance when a new tax law is passed or when there is minimal administrative or judicial authority to help interpret the law.

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 1 Easy

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EA: No

56. What is the purpose of the Joint Conference Committee? Its reports are considered more important or are more authoritative. Why?

Answer:

The Joint Conference Committee is composed of members of both the House Ways and Means Committee and the Senate Finance Committee. It is formed when the House and the Senate have passed different versions of a tax bill. The purpose of the joint committee is to resolve any conflicts between the two versions. Thus, the committee reports from the Joint Conference Committee are the last reports and contain the discussion of the intent regarding the final bill sent to the President for signature.

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 2 Medium
EA: No

57. Explain what is meant by Public Law 100-14.

Answer:

Public Law 100-14 is the 14th bill of the 100th Congress that was signed into law. All legislation passed by Congress and signed into law follows this numbering system—whether it is a tax bill or otherwise.

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 1 Easy
EA: No

58. What is administrative authority, and who publishes it?

Answer:

Administrative authority is the IRS's interpretation of the IRC. It is developed and published by the IRS.

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 1 Easy
EA: No

59. What is a Proposed Regulation? Can a taxpayer rely on a Proposed Regulation as authority on how to treat a certain tax item?

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Answer:

The IRS writes Proposed Regulations during the hearing process leading up to the issuance of Final or General Regulations. The purpose of Proposed Regulations is to generate discussion and/or criticism of the IRS's interpretation of the IRC. The taxpayer can rely on a Proposed Regulation absent any other contradictory tax authority. However, Proposed Regulations do not have the effect of law, so the tentative position may be overturned. Reliance on a Proposed Regulation is treated as authority for possible imposition of a negligence penalty (the reversed tax position would not be subject to a negligence penalty).

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 2 Medium
EA: No

60. Can a taxpayer rely on a Temporary Regulation as authority on how to treat a certain tax item? If so, how long is a Temporary Regulation valid?

Answer:

Taxpayers can rely on Temporary Regulations. A Temporary Regulation has the same tax authority as a general or final regulation. It is effective as soon as it is issued and expires three years from the date of issuance.

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 1 Easy
EA: No

61. Differentiate between a General Regulation and a Legislative Regulation. Which one is the stronger tax authority?

Answer:

The IRS writes General Regulations to interpret the IRC under the general authority given to the IRS by Congress. A Legislative Regulation is a regulation written by the IRS under a direct mandate by Congress. In other words, Congress tells (or gives power to) the IRS to write the actual law through a Legislative Regulation. Legislative Regulations have the full effect of law and are the strongest administrative authority.

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 2 Medium
EA: No

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62. Where are Revenue Rulings and Revenue Procedures found? When might a Revenue Ruling be useful to a taxpayer? When might a Revenue Procedure be useful to a taxpayer?

Answer:

The IRS publishes all Revenue Rulings and Procedures in a publication series called the *Cumulative Bulletin*. Rulings and Procedures can also be located on the web at www.irs.gov and other locations. Revenue Rulings are most useful to a taxpayer in determining the proper tax position to use regarding a given fact scenario. Revenue Procedures are used more often to provide resources such as tables, rates, guidelines, and safeguards (e.g., tax depreciation tables, inflation adjusted items, etc.).

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 2 Medium
EA: No

63. In what courts are disputes between the IRS and a taxpayer heard?

Answer:

The three trial courts that hear tax disputes between the IRS and taxpayers are the U.S. District Courts, the U.S. Tax Court, and the U.S. Court of Federal Claims.

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 1 Easy
EA: No

64. What are the advantages in petitioning the Tax Court versus other trial courts?

Answer:

The major advantage of filing a case with the Tax Court is that the taxpayer need not pay the amount of disputed tax before filing a petition. Another advantage is that the Tax Court justices are tax law specialists. However, the second advantage can also be a disadvantage if the tax authority is not sufficiently on the taxpayer's side as might be the case if emotional or undue circumstances caused the deficiency.

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 1 Easy
EA: Yes

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65. When would a taxpayer want to sue the government in a district court versus the Tax Court?

Answer:

A U.S. District Court allows jury trial. A judge who is a tax specialist decides Tax Court cases. Therefore, if the taxpayer's case is an emotional issue, but the tax law is not totally favorable towards their position, a trial by a jury may produce a more positive outcome.

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 2 Medium
EA: No

66. If a taxpayer loses a case against the IRS in one of the three trial courts, does the taxpayer have any avenue for appeals?

Answer:

Any of the trial courts' decisions may be appealed to the U.S. Court of Appeals.

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 1 Easy
EA: No

67. After the Court of Appeals, does the taxpayer have any additional avenue for appeals? If so, what are the taxpayer's probabilities of receiving an appeal after the Court of Appeals? Why?

Answer:

All of the Court of Appeals cases can be appealed to the U.S. Supreme Court. However, the Supreme Court hears few tax cases each year. The only tax cases the Supreme Court usually agrees to rule on are cases where a conflict occurs between the rulings of several different courts.

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 1 Easy
EA: No

68. Why might a district court's opinion regarding a tax decision be more likely to be reversed on appeal?

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Answer:

A district court ruling may be decided by a jury or by a judge that is not a tax specialist. Upon appeal, the tax authority is weighted more heavily, and emotional reasons for a verdict are more likely to be disregarded.

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 1 Easy
EA: No

69. (Longer Answer) What is a Treasury Regulation? What are the four types of regulations and how do they differ?

Answer:

A Treasury Regulation is written by the IRS (the IRS is a division of the U.S. Treasury Department). A Treasury Regulation is the strongest administrative authority and is the IRS's direct interpretation of the IRC.

The four types of regulations are:
***Legislative* — written under a direct mandate from Congress and have the full effect of law.**
***General or Final Regulations* — written by the IRS under its general authority to interpret the IRC.**
***Temporary Regulations* — the IRS issues these regulations to give taxpayers immediate guidance on the effect of a new law. They expire three years after they are issued.**
***Proposed Regulations* — the IRS writes these regulations during the hearing process concerning general regulations. The purpose of these regulations is to generate discussion and/or criticism of the IRS's interpretation of the IRC.**

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 1 Easy
EA: No

70. (Longer Answer) What is the difference between a Revenue Ruling and a Revenue Procedure? How does the level of authority of a ruling or procedure compare with regulations and statutory authority?

Answer:

With a Revenue Ruling, the IRS reacts to an area of the tax law that is confusing to many taxpayers. Revenue Rulings are usually issued after numerous taxpayers have requested guidance through Private Letter Rulings on a particular tax situation.

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The IRS usually issues Revenue Procedures to illustrate the manner in which it wants something reported. In other words, a Revenue Procedure is usually proactive.

Revenue Rulings and Procedures carry less authoritative weight than regulations and statutory authority. However, they are considered strong tax authority. When a tax professional is researching a tax issue, Rulings and Procedures are an especially useful source of information because they reference other tax authorities (law, court cases, etc.) as part of the justification for the position of the IRS.

Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 2 Medium
EA: No

Multiple Choice Questions Pertaining to Appendix A

71. Which of the following is (are) primary sources of tax authority?
    a. Statutory sources.
    b. Administrative sources.
    c. Judicial sources.
    d. All of the above.

Answer: d.
Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 1 Easy
EA: No

72. Which of the following is a statutory source of tax authority?
    a. Internal Revenue Code.
    b. Regulations.
    c. Revenue Rulings.
    d. Tax Court decision.

Answer: a.
Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 1 Easy
EA: No

73. Which of the following types of IRS Regulations have the greatest strength of authority?
    a. General or Final Regulations.
    b. Legislative Regulations.

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c. Proposed Regulations.
d. Temporary Regulations.

Answer: b.
Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 1 Easy
EA: No

74. Which of the following refers to an income tax regulation?
a. Reg. §1.162-5.
b. Reg. §20.2032-1.
c. Reg. §25.2503-4.
d. Reg. §31.3301-1.

Answer: a.
Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 1 Easy
EA: No

75. Which of the following trial court(s) hear tax cases?
a. U.S. Tax Court.
b. U.S. district courts.
c. U.S. Court of Federal Claims.
d. All of the above.

Answer: d.
Learning Objective: 01-05
Topic: Tax Authority
Difficulty: 1 Easy
EA: No

Discussion Questions Pertaining to Appendix B (LO 6)

76. IRS rules for paid tax preparers apply to what types of tax professionals?

Answer:
Paid tax preparer rules under Circular 230 apply to CPAs, attorneys, enrolled agents, registered tax preparers, or any other person who, for compensation, prepares a tax return, provides tax advice, or practices before the IRS.
Learning Objective: 01-06
Topic: IRS Rules for Paid Tax Preparers and Paid Preparer Penalties
Difficulty: 1 Easy
EA: Yes

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77. Who must obtain a preparer tax identification number?

Answer:

Any paid preparer must obtain a preparer tax identification number. A paid preparer is someone who, for compensation, prepares all or substantially all of a tax return or tax form submitted to the IRS or a claim for refund.

Learning Objective: 01-06
Topic: IRS Rules for Paid Tax Preparers and Paid Preparer Penalties
Difficulty: 1 Easy
EA: Yes

78. List at least five items that paid preparers must do to comply with Circular 230.

Answer:

The text lists nine items that a paid preparer must do. An appropriate answer would include any five from the list. The list is:

- **Sign all tax returns they prepare.**
- **Provide a copy of the returns to clients.**
- **Return records to clients.**
- **Exercise due diligence.**
- **Exercise best practices in preparing submissions to the IRS.**
- **Disclose all non-frivolous tax positions when such disclosure is required to avoid penalties.**
- **Promptly notify clients of any error or omission on a client tax return.**
- **Provide records and information requested by the IRS unless the records or information are privileged.**
- **Inform a client if the client has made an error or omission in a document submitted to the IRS.**

Learning Objective: 01-06
Topic: IRS Rules for Paid Tax Preparers and Paid Preparer Penalties
Difficulty: 1 Easy
EA: Yes

79. List at least five items that paid preparers must not do to comply with Circular 230.

Answer:

The text lists seven items that a paid preparer must not do. An appropriate answer would include any five from the list. The list is:

- **Take a tax position on a return unless there is a "realistic possibility" of the position being sustained.**
- **Charge a fee contingent on the outcome of the return or any position, except in certain limited situations.**
- **Charge an "unconscionable fee."**
- **Unreasonably delay the prompt disposition of any matter before the IR S.**
- **Cash an IRS check for a client for whom the return was prepared.**

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- **Represent a client before the IRS if the representation involves a conflict of interest.**
- **Make false, fraudulent, or coercive statements or claims or make misleading or deceptive statements or claims. In part, this item pertains to claims made with respect to advertising or marketing.**

Learning Objective: 01-06
Topic: IRS Rules for Paid Tax Preparers and Paid Preparer Penalties
Difficulty: 1 Easy
EA: Yes

80. List at least three monetary penalties to which a paid preparer is subject.

Answer:

The text lists seven potential monetary penalties. An appropriate answer would include any three from the list. The list is:

- **Take an unreasonable tax position.**
- **Use willful or reckless conduct to prepare the return.**
- **Fail to furnish a copy of the prepared return to the taxpayer.**
- **Fail to sign the return.**
- **Fail to furnish a PTIN**
- **Negotiate a refund check**
- **Not be diligent to determine taxpayer eligibility for certain tax benefits including education credits, Earned Income Tax Credit, or any dependent credit.**

Learning Objective: 01-06
Topic: IRS Rules for Paid Tax Preparers and Paid Preparer Penalties
Difficulty: 1 Easy
EA: Yes

Multiple Choice Questions Pertaining to Appendix B (LO 6)

81. A preparer tax identification number must be obtained by:
    a. only CPAs, attorneys, and enrolled agents.
    b. only individuals who are not CPAs, attorneys, or enrolled agents.
    c. any individual who is paid to prepare a tax return.
    d. only individuals who prepare a Form 1040.

Answer: c.
Learning Objective: 01-06
Topic: IRS Rules for Paid Tax Preparers and Paid Preparer Penalties
Difficulty: 1 Easy
EA: Yes

82. A paid preparer must *not*:
    a. cash a client's IRS check.

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b. charge a reasonable fee.
c. inform a client if the preparer makes a mistake on the client's tax return.
d. provide a client with a copy of their return.

Answer: a.
Learning Objective: 01-06
Topic: IRS Rules for Paid Tax Preparers and Paid Preparer Penalties
Difficulty: 1 Easy
EA: Yes

83. A paid preparer must:
a. ignore a conflict of interest when representing a client before the IRS.
b. charge a contingent fee.
c. sign all tax returns prepared.
d. provide records requested by the IRS in all circumstances.

Answer: c.
Learning Objective: 01-06
Topic: IRS Rules for Paid Tax Preparers and Paid Preparer Penalties
Difficulty: 1 Easy
EA: Yes

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CHAPTER 1
INTRODUCTION TO TAXATION, THE INCOME TAX FORMULA, AND FORM 1040

Learning Objectives

LO 1. Understand progressive, proportional, and regressive tax structures.
LO 2. Understand the concepts of marginal and average tax rates as well as a simple income tax formula.
LO 3. Understand the components of a basic Form 1040 income tax return.
LO 4. Determine tax liability in instances when a Form 1040 return is appropriate.
LO 5. Understand the types of tax authority and how they interrelate (Appendix A).
LO 6. Understand the provisions of IRS Circular 230 for paid tax preparers as well as paid preparer penalties (Appendix B).

Topics of Primary Importance

- Determination of taxable income.
- Calculation of tax liability.
- The types of tax authority and relative strengths.

Student Confusion Areas

- Understanding tax terminology and the precision inherent in terminology.
- The difference between marginal tax rates and average tax rates.
- The tax refund or amount owed is simply the amount to "settle up" with the IRS. It does not represent the amount of total tax liability.

Note to Instructor

We have designed this text to be used with the TaxACT software, and you can easily incorporate the software in your instruction and student homework. ***Alternatively*****,** you can choose to ignore the software and have students use IRS forms and calculate returns by hand. Some instructors require students to calculate returns by hand for the first three to five chapters and then switch to the software. You have complete flexibility.

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If you have your students use the software, make sure you require them to update their software using the online update feature of the program. If they fail to do so, they will not be able to print returns.

Notes Outline

I. Introduction

A. The introduction materials help the student understand the legal basis of income taxation, provide an overview of the types of returns and numbers, and an understanding of the dollar volume of income tax collections.
B. Students find the numbers in Table 1-1 and the material in the preceding paragraph to be interesting.

II. LO 1 – Understand progressive, proportional, and regressive tax structures.

A. Students need to understand the notions of tax base and tax rate.
    1. The base is the dollar amount upon which tax will be calculated.
    2. The rate is the tax proportion to apply to the base.

B. Progressive rate structure
    1. Tax rate increases as the tax base increases.
    2. U.S. individual income tax system is a progressive system.
    3. Refer students to Table 1-2 or the tax rate schedules in Appendix F.
    4. Table 1-3 also illustrates the progressivity of the U.S. tax system.

C. Proportional rate structure
    1. Tax rate is the same regardless of the tax base.
    2. Common example is state or local sales tax.
    3. If we change to a flat tax system, we would be changing from a progressive rate structure to a proportional rate structure.

D. Regressive rate structure
    1. Tax rate decreases as the tax base increases.
    2. Social Security tax is a good example. Stops at $168,600 limit.

III. LO 2 – Understand the concepts of marginal and average tax rates as well as a simple income tax formula.

A. Marginal tax rate is the rate on the next dollar of income.

B. Average tax rate is the total tax liability divided by taxable income.

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C. Mathematically, an average tax rate is a combination of a series of marginal rates.

D. The simple income tax formula that forms the basic structure of all returns is:

Income
– Permitted Deductions from Income

= Taxable Income
× Appropriate Tax Rates

= Tax Liability
– Tax Payments and Tax Credits

= Tax Refund or Tax Due with Return

IV. LO 3 – Understand the components of a basic Form 1040 income tax return.

A. The Form 1040 is the form all taxpayers will use to file their individual income tax returns.

B. There are three Schedules that can be included with Form 1040. As a tax return becomes more complex, a taxpayer will use one or more of the Schedules.

C. Wages include salaries, tips, commissions, bonuses, severance pay, and other "compensation for services."
    1. Wages are reported to employees on Form W-2.

D. Interest is generally taxable. Interest is compensation for the use of money with respect to a bona fide debt.

E. Unemployment compensation is taxable because it is viewed as a substitute for taxable wages.

F. Taxpayers are permitted a standard deduction from income on line 12 of Form 1040.
    1. The line 12 deduction is either $14,600 for single taxpayers or $29,200 for taxpayers filing married.

G. Taxable income (line 15) is equal to the sum of the income items (lines 1–8) minus the adjustment on line 10 and minus the deductions totaled on line 14.
    1. Taxable income is the tax base used to determine tax liability.
    2. It is instructive at this point for students to clearly distinguish between total income and taxable income. This is a case where words have a very precise meaning—total income is very different from taxable income.

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V. LO 4 – Determine tax liability in instances when a Form 1040 return is appropriate.

A. Tax liability is determined with reference to the tax tables printed in Appendix D and in the instructions to Form 1040 available on the IRS website.

B. Tax tables only go up to taxable income of $100,000. For income over this limit, the tax rate schedules must be used. These schedules are printed in Appendix F.

In-class Example – Students find it helpful to have some in-class practice determining tax liability with reference to the tax tables. The instructor can choose various amounts of taxable income for either single or married taxpayers and have the students "go into" the tax tables to determine tax liability.

C. Point out the effect on tax liability of different filing statuses. Students can see the effect if they refer to the tax tables and read across a row.

D. The tax table liability is calculated using the mid-point of the taxable income range provided. Students can calculate precise tax liability using the tax rate schedules in Appendix F and compare their results to the tax table numbers.

In-class Discussion Point – An instructor may wish to ask the question why the tax tables are necessary when everyone could use the tax rate schedules and get a precise number. One reasonable response is that the tax tables are easier to use and are not subject to as many errors.

VI. LO 3 – Understand the components of a basic Form 1040 income tax return.

A. Most taxpayers pay some or all of their tax liability prior to the due date of the return. The vast majority of taxpayers do so using income tax withholding from their paycheck. Some taxpayers need to make quarterly estimated tax payments.

B. Taxpayers can take an Earned Income Tax Credit on their Form 1040. The EIC is discussed in Chapter 9 along with other credits.

C. The tax refund or tax due with the return is determined by comparing the tax liability on line 24 with the amount paid on line 33.

D. The refund or amount owed is the amount needed to "settle up" with the IRS.

VII. LO 5 – Understand the types of tax authority and how they interrelate (Appendix A).

Note to Instructors. If you want your students to be able to perform tax research, whether simple or complex, the material in the Appendix is an important starting point.

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A. Taxes are complex. While there are some absolute answers, often "it depends" is the initial response to a tax question. To determine an answer, the tax practitioner often needs to refer to "tax authority"—the law, regulations, guidelines, and precedent that form the basis of proper tax reporting. The Appendix exposes students to the various types of tax authority and their relative strengths.

B. There are three types of tax authority.
    1. Statutory Sources
    2. Administrative Sources
    3. Judicial Sources

C. Statutory sources are the U.S. Constitution and tax laws passed by Congress. These tax laws comprise the Internal Revenue Code.

D. Administrative sources, in order of strength, are: IRS Regulations, Revenue Rulings, Revenue Procedures, Private Letter Rulings, and IRS Notices.

E. Judicial sources are the rulings from the courts. Figure 1-1 in the text illustrates applicable courts and appeal tracks.

VIII. LO 6 – Understand the provisions of IRS Circular 230 for paid tax preparers as well as paid preparer penalties (Appendix B).

Students and instructors are encouraged to download Circular 230 from the IRS website.

A. All individuals who, for compensation, prepare a tax return, provide tax advice, or practice before the IRS are subject to the provisions of Circular 230. It is important to note that Circular 230 covers work and activities which are paid (compensated).

B. Failure to comply with Circular 230 will subject the individual to possible suspension or disbarment, public censure, fines, or civil or criminal prosecution.

C. Paid tax preparers must register with the IRS and obtain a preparer tax identification number (PTIN). The PTIN must be renewed annually.

D. Continuing professional education is required annually. Some professionals (CPAs, attorneys) obtain their continuing education as part of their licensure process. Enrolled agents must obtain at least 72 hours every three years, and others must receive at least 15 hours annually. Ethics and professional conduct must be part of the continuing education.

E. Circular 230 sets forth numerous actions which paid preparers must, or must not, do. A summary of these actions is provided in the Appendix.

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F. Paid preparers may be subject to monetary penalties. These include penalties for taking an unreasonable tax position, willful or reckless conduct to prepare the return, failure to furnish a copy of the return to the taxpayer, and not being diligent to determine taxpayer eligibility for certain tax benefits and credits.

G. Paid preparers are also subject to civil and/or criminal penalties in the case of committing fraud or making false statements on returns, if they prepare fraudulent returns, or if they recklessly disclose information used to prepare returns.

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