Fundamentals of Taxation for Individuals and Business Entities 2026 3rd edition Carnes Test Bank

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Fundamentals of Taxation for Individuals and Business Entities, 2026
Test Bank
Chapter 1: The Professional Practice of Taxation

1) Which of the following is false about tax planning?
A) The appropriate goal for tax planning is to maximize after-tax income.
B) The appropriate goal for tax planning is to minimize a taxpayer's tax liability for the year.
C) Once a taxpayer understands the tax consequences of a particular transaction, they can move on to the tax planning stage.
D) Tax evasion is not a tax planning strategy.

Answer: B
Explanation: Minimizing a taxpayer's liability is not the appropriate goal for tax planning because if that were the goal, it could be met by reducing a taxpayer's income to zero–actually an easy goal to meet. If a taxpayer has no income for the year, then there will be no tax liability, and you will have minimized their taxes. But your client will also be a very poor and hungry person, so this cannot be the proper goal.
Diff: 1
Learning Objective: LO 1.1
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.1
Time on Task: 5 min

2) Jessica has received several job offers from various accounting firms located in 4 different states. She has performed an analysis to determine her income, her non-income tax costs (e.g. cost of living, etc.) and income tax. Jessica is trying to make a decision on which offer to accept, and she has asked for your advice. Based on the appropriate goal of tax planning, which of the following states would you advise Jessica to choose?

	Gross Wages	Non-Income Tax Costs	Income Tax
California	120,000	52,000	24,000
New York	100,000	37,000	20,000
Virginia	70,000	10,800	10,500
Texas	50,000	6,000	5,000

A) Texas

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B) California
C) Virginia
D) New York

Answer: C
Explanation: The appropriate goal for tax planning is to maximize after-tax income. After-tax income is net income after reducing revenue for all expenses, including federal income taxes. See table below for calculation of after-tax income for each state. With that in mind, you should advise Jessica to choose Virginia because doing so maximizes her after-tax income. The state with the lowest income tax (i.e., Texas) is not the right answer because minimizing a taxpayer's liability is not the appropriate goal for tax planning because if that were the goal, then the ultimate success would be to reduce a taxpayer's tax liability to zero–an easy goal to meet. If a taxpayer has no income for the year, then there will be no tax liability, and you will have minimized their taxes. But your client will also be a very poor and hungry person, so this cannot be the proper goal.

	Gross Wages (A)	**Non-Income Tax Costs (B)**	**Income Tax (C)**	**After-Tax Income (D) = (A) - (B) - (C)**
California	120,000	52,000	24,000	44,000
New York	100,000	37,000	20,000	43,000
Virginia	70,000	10,800	10,500	**48,700**
Texas	50,000	6,000	5,000	39,000

Diff: 2
Learning Objective: LO 1.1
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Application
Section Reference: Sec. 1.1
Time on Task: 8 min

3) Which of the following is not correct regarding tax and non-tax costs?
A) Both tax and non-tax costs must be considered when making financial and investment decisions.
B) Tax costs include any type of tax paid to a local, state, federal, or foreign government.
C) Non-tax costs are all costs other than tax costs.
D) Effective tax planning requires prioritizing tax costs.

Answer: D

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Explanation: Effective tax planning requires consideration of both tax and non-tax costs.
Diff: 1
Learning Objective: LO 1.1
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.1
Time on Task: 5 min

4) Samson's wages are $100,000. He lives in Maryland and his expenses include $25,000 rent, $12,000 other living expenses, $27,000 income tax, $6,200 payroll tax and $5,500 property tax. What are Samson's tax costs?
A) $27,000
B) $33,200
C) $61,300
D) $38,700

Answer: D
Explanation: $38,700 = $27,000 + $6,200 + $5,500. Tax costs include any type of tax paid to a local, state, federal, or foreign government.
Diff: 1
Learning Objective: LO 1.1
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Application
Section Reference: Sec. 1.1
Time on Task: 5 min

5) Samson's wages are $100,000. He lives in Maryland and his expenses include $25,000 mortgage interest, $12,000 other living expenses, $27,000 income tax, $6,200 payroll tax and $5,500 property tax. What are Samson's non-tax costs?
A) $37,000
B) $12,000
C) $61,300
D) $38,700

Answer: A
Explanation: $37,000 = $25,000 + $12,000. Non-tax costs are all costs other than tax costs. Tax costs include any type of tax paid to a local, state, federal, or foreign government.
Diff: 1

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Learning Objective: LO 1.1
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Application
Section Reference: Sec. 1.1
Time on Task: 5 min

6) Samson's wages are $100,000. He lives in Maryland and his non-tax costs include $25,000 rent and $12,000 other living expenses. His tax costs include $27,000 income tax, $6,200 payroll tax and $5,500 property tax. What is Samson's after-tax income?
A) $73,000
B) $24,300
C) $61,300
D) $29,000

Answer: B
Explanation: $24,300 = $100,000 - $25,000 - $12,000 - $27,000 - $6,200 - $5,500. After-tax income is net income after reducing revenue for all expenses, including federal income taxes.
Diff: 2
Learning Objective: LO 1.1
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Application
Section Reference: Sec. 1.1
Time on Task: 8 min

7) Which of the following statements is false?
A) Individuals file their individual income taxes on Form 1040.
B) Income lines on the Form 1040 are Line 1 - 9
C) Deduction lines on Form 1040 are Line 10, 12 - 13
D) Demographic information is included on the second page of the Form 1040

Answer: D
Explanation: The top half of page 1 of Form 1040 is for demographic information.
Diff: 1
Learning Objective: LO 1.2
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Application
Section Reference: Sec. 1.2
Time on Task: 5 min

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8) Which of the following are reported on Schedule 1 of the 1040?
A) Student loan interest deduction
B) Self-employment tax
C) Repayment of first-time homebuyer credit
D) Foreign tax credit

Answer: A
Explanation: Schedule 1 is used to report additional income and adjustments to income. Student loan interest deduction is reported on Schedule 1. Foreign tax credits are reported on Schedule 3. Self-employment tax and repayment of first-time homebuyer credit are reported on Schedule 2.
Diff: 2
Learning Objective: LO 1.2
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.2
Time on Task: 5 min

9) Which of the following are reported on Schedule 2 of the 1040?
A) Student loan interest deduction
B) Taxable refunds or credits
C) Repayment of first-time homebuyer credit
D) Foreign tax credit

Answer: C
Explanation: Schedule 2 is used to report additional taxes. Repayment of first-time homebuyer credit is reported on Schedule 2. Student loan interest deduction and Taxable refunds or credits are reported on Schedule 1. Foreign tax credits are reported on Schedule 3.
Diff: 2
Learning Objective: LO 1.2
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.2
Time on Task: 5 min

10) Which of the following are reported on Schedule 3 of the 1040?
A) Student loan interest deduction

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B) Self-employment tax
C) Repayment of first-time homebuyer credit
D) Foreign tax credit

Answer: D
Explanation: Schedule 3 is used to report additional payments and credits. Foreign tax credits are reported on Schedule 3. Student loan interest deduction is reported on Schedule 1. Self-employment tax and repayment of first-time homebuyer credit are reported on Schedule 2.
Diff: 2
Learning Objective: LO 1.2
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.2
Time on Task: 5 min

11) Which of the following is false?
A) Schedule 2 is used to report additional taxes.
B) Repayment of first-time homebuyer credit is reported on Schedule 3.
C) The Schedule 3 is used to report additional payments and credits.
D) Adoption credit is reported on Schedule 3.

Answer: B
Explanation: Repayment of first-time homebuyer credit is reported on Schedule 2.
Diff: 2
Learning Objective: LO 1.2
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.2
Time on Task: 5 min

12) Tariq has a mortgage interest credit of $7,000 and taxable state refund of $3,000. On what schedules of the 1040 should Tariq report the mortgage interest credit and the taxable state refund?
A) Both the mortgage interest credit and the Taxable state refund should be reported on Schedule 2.
B) The mortgage interest credit is reported on Schedule 3 while the Taxable State refund is reported on Schedule 1.
C) The mortgage interest credit is reported on Schedule 1 while the Taxable State refund is

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reported on Schedule 2.
D) Both the mortgage interest credit and the Taxable state refund should be reported on Schedule 3.

Answer: B
Explanation: The mortgage interest credit is reported on Schedule 3 while the Taxable State refund is reported on Schedule 1. Schedule 1 is used to report additional income and adjustments to income. Schedule 2 is used to report additional taxes. Schedule 3 is used to report additional payments and credits.
Diff: 2
Learning Objective: LO 1.2
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.2
Time on Task: 5 min

13) Tariq has a mortgage interest credit of $1,400, unemployment compensation of $400, and taxable state refund of $3,000. What is the total amount to be reported on schedule 1 of the 1040?
A) $400
B) $2,000
C) $3,000
D) $3,400

Answer: D
Explanation: $3,400 = $3,000 + $400. The mortgage interest credit is reported on Schedule 3 while the Taxable State refund and unemployment compensation are reported on Schedule 1. Schedule 1 is used to report additional income and adjustments to income. Schedule 2 is used to report additional taxes. Schedule 3 is used to report additional payments and credits.
Diff: 2
Learning Objective: LO 1.2
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.2
Time on Task: 5 min

14) Tariq has a mortgage interest credit of $1,400, unemployment compensation of $400, and taxable state refund of $3,000. What is the total amount to be reported on schedule 2 of the

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1040?
A) $400
B) $2,000
C) $0
D) $3,400

Answer: C
Explanation: $0. The mortgage interest credit is reported on Schedule 3 while the Taxable State refund and unemployment compensation are reported on Schedule 1. Schedule 1 is used to report additional income and adjustments to income. Schedule 2 is used to report additional taxes. Schedule 3 is used to report additional payments and credits.
Diff: 2
Learning Objective: LO 1.2
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.2
Time on Task: 5 min

15) Tariq has a mortgage interest credit of $1,400, unemployment compensation of $400, and taxable state refund of $3,000. What is the total amount to be reported on schedule 3 of the 1040?
A) $1,400
B) $2,000
C) $3,000
D) $3,400

Answer: A
Explanation: $1,400. The mortgage interest credit is reported on Schedule 3 while the Taxable State refund and unemployment compensation are reported on Schedule 1. Schedule 1 is used to report additional income and adjustments to income. Schedule 2 is used to report additional taxes. Schedule 3 is used to report additional payments and credits.
Diff: 2
Learning Objective: LO 1.2
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.2
Time on Task: 5 min

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16) Which of the following is false?
A) Closed transactions are preferred over open transactions.
B) Marginal tax rates should always be used when evaluating tax planning alternatives.
C) Variances in rates across time period creates tax planning opportunities.
D) Saving a dollar of taxes today is worth more than saving a dollar of taxes next year.

Answer: A
Explanation: A tax professional prefers an open transaction because the tax professional can consider a range of options for structuring the transaction and choose the one that has the best tax results for his/her client.
Diff: 1
Learning Objective: LO 1.3
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.3
Time on Task: 5 min

17) What rates should always be used when evaluating tax planning alternatives?
A) Federal tax rate only
B) Federal and state tax rate
C) Statutory tax rate of the applicable jurisdiction
D) Marginal tax rate

Answer: D
Explanation: Marginal tax rates should always be used when evaluating tax planning alternatives.
Diff: 1
Learning Objective: LO 1.3
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.3
Time on Task: 5 min

18) Which of the following is false?
A) An open transaction is a transaction that is not yet completed.
B) A closed transaction is one where the relevant events have already happened, and the facts are set.
C) A closed transaction provides opportunity for tax planning.

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D) Open transactions are preferred over closed transactions for tax planning.

Answer: C
Explanation: A closed transaction doesn't result in tax planning because the relevant events have already happened, and the facts are set. A closed transaction results in tax compliance.
Diff: 1
Learning Objective: LO 1.3
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.3
Time on Task: 5 min

19) Sharon has a total income of $1,500,000, taxable income of $800,000 and a tax liability of $200,000. Each additional dollar of deduction will save her 37 cents in taxes. What is Sharon's marginal, average, and effective tax rates?
A) Marginal tax rate = 37%; Average tax rate = 37%; Effective tax rate = 37%
B) Marginal tax rate = 37%; Average tax rate = 13%; Effective tax rate = 25%
C) Marginal tax rate = 37%; Average tax rate = 25%; Effective tax rate = 13%
D) Marginal tax rate = 37%; Average tax rate = 25%; Effective tax rate = 5%

Answer: C
Explanation: Marginal tax rate = 37% (0.37 / 1). Marginal tax rate is the tax rate applied to the next additional dollar of income earned. Average tax rate = 25% = ($200,000 / $800,000). Average Tax rate is total income tax divided by taxable income. Effective tax rate = 13% ($200,000 / $1,500,000). Effective tax rate is the total income tax divided by total income.
Diff: 2
Learning Objective: LO 1.3
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Analysis
Section Reference: Sec. 1.3
Time on Task: 8 min

20) Stacy is a single filer. Her taxable income is $255,000. Her total income is $310,000. The applicable tax rate schedule for Stacy in 2025 is:

If Taxable Income is:	The Tax Is:
Over $250,525 but not over $626,350	$57,231 plus 35% of excess over $250,525

What is Stacy's marginal tax rate?
A) 35%

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B) 13.30%
C) 23.76%
D) 19.16%

Answer: A
Explanation: Based on the tax rate schedule, her marginal tax rate = 35%. Marginal tax rate is the tax rate applied to the next additional dollar of income earned.
Diff: 1
Learning Objective: LO 1.3
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Analysis
Section Reference: Sec. 1.3
Time on Task: 5 min

21) Stacy is a single filer. Her taxable income is $255,000. Her total income is $310,000. The applicable tax rate schedule for Stacy in 2025 is:

If Taxable Income is:	The Tax Is:
Over $250,525 but not over $626,350	$57,231 plus 35% of excess over $250,525

What is Stacy's tax liability?
A) $57,231
B) $58,797.25
C) $89,250
D) $108,500

Answer: B
Explanation:

Taxable Income	$ 255,000
Less: Threshold for 35% tax bracket	$ (250,525)
Income taxed at 35%	$ 4,475
	× 35%
	$ 1,566.25
Plus: Tax on $250,525	$ 57,231.00
Tax Liability	**$ 58,797.25**

Diff: 3
Learning Objective: LO 1.3
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Analysis
Section Reference: Sec. 1.3
Time on Task: 10 min

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22) Stacy is a single filer. Her taxable income is $255,000. Her total income is $310,000. The applicable tax rate schedule for Stacy in 2025 is:

If Taxable Income is:	The Tax Is:
Over $250,525 but not over $626,350	$57,231 plus 35% of excess over $250,525

What is Stacy's average tax rate?
A) 35%
B) 13.30%
C) 23.06%
D) 18.97%

Answer: C
Explanation:

Taxable Income	$	255,000
Less: Threshold for 35% tax bracket	$	(250,525)
Income taxed at 35%	$	4,475
	×	35%
	$	1,566.25
Plus: Tax on $250,525	$	57,231.00
Tax Liability	$	58,797.25

Average Tax Rate $= \frac{\textbf{Total Income Tax (\$58,797.25)}}{\textbf{Taxable Income (\$255,000)}} =$ **23.06%**

Diff: 3
Learning Objective: LO 1.3
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Analysis
Section Reference: Sec. 1.3
Time on Task: 15 min

23) Stacy is a single filer. Her taxable income is $255,000. Her total income is $310,000. The applicable tax rate schedule for Stacy in 2025 is:

If Taxable Income is:	The Tax Is:
Over $250,525 but not over $626,350	$57,231 plus 35% of excess over $250,525

What is Stacy's effective tax rate?
A) 35%
B) 13.30%
C) 23.06%
D) 18.97%

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Answer: D
Explanation:

Taxable Income	$	255,000
Less: Threshold for 35% tax bracket	$	(250,525)
Income taxed at 35%	$	4,475
		× 35%
	$	1,566.25
Plus: Tax on $250,525	$	57,231.00
Tax Liability	$	58,797.25

Effective Tax Rate = $\frac{\textbf{Total Income Tax (\$58,797.25)}}{\textbf{Total Income (\$310,000)}}$ = **18.97%**

Diff: 3
Learning Objective: LO 1.3
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Analysis
Section Reference: Sec. 1.3
Time on Task: 15 min

24) Which of the following is false about rates varying across time periods?
A) If rates are increasing in the future, it is best to accelerate income.
B) If rates are increasing in the future, it is best to accelerate deductions.
C) If rates are decreasing in the future, it is best to accelerate deductions.
D) If rates are decreasing in the future, it is best to defer income in the current year.

Answer: B
Explanation: If rates are increasing in the future, it is best to accelerate income and defer deductions in the current year.
Diff: 1
Learning Objective: LO 1.3
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Analysis
Section Reference: Sec. 1.3
Time on Task: 5 min

25) Sally is in the 22% tax bracket in Y1. She expects to be in the 24% tax bracket next year due to a promotion. She intends to make a charitable contribution of $7,500 to her alma mater.

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Which of the following is true?
A) The best tax planning strategy for Sally is to make the contribution in either Y1 or Y2 because the amount is the same.
B) The best tax planning strategy for Sally is to make the contribution in Y2.
C) The best tax planning strategy for Sally is to make the contribution in Y1.
D) If rates are increasing in the future, it is best to accelerate deductions.

Answer: B
Explanation: If rates are increasing in the future, it is best to accelerate income and defer deductions in the current year. Since Sally is going from a 22% tax bracket to a 24% tax bracket, the best tax planning strategy is to defer her contributions to Y2.
Diff: 2
Learning Objective: LO 1.3
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Analysis
Section Reference: Sec. 1.3
Time on Task: 5 min

26) In Y1, Dana lives in Texas, a state with no income tax and she is in the 22% tax bracket for federal purposes. Dana accepted a job offer in VA and will move to VA for the job in Y2. In Y2, her marginal tax rate will be 8% in VA and 24% for federal purposes. She plans to make a charitable contribution of $2,500 to her church in either Y1 or Y2. Which of the following is true?
A) If Dana makes a donation, she decreases her tax savings by $50.
B) If Dana makes a donation in Y1, Dana's tax savings will be same in Y1 or Y2.
C) If Dana makes a donation in Y2, she increases her tax savings by $200.
D) If Dana makes a donation in Y2, she increases her tax savings by $250.
Answer: D
Explanation: If rates are increasing in the future, it is best to accelerate income and defer deductions in the current year. Since Dana is going from a 22% tax bracket to a 24% tax bracket for federal purposes and 0% to 8% tax bracket for state purposes, this means her marginal rates are increasing by 10% and it is best to defer her deductions. The 10% increase is calculated as 8% (8% - 0%) + 2% (24% - 22%). Her tax savings increases by $250 if she makes the donation in Y2. $2,500 × (10%) = $250.
Diff: 2
Learning Objective: LO 1.3
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Analysis
Section Reference: Sec. 1.3

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Time on Task: 5 min

27) Which of the following is false?
A) Different tax rates apply to different types of income.
B) Long-term capital gains are taxed at different tax rates than short-term capital gains.
C) Short-term capital gains are taxed at a lower tax rate than long-term capital gains.
D) Generally, a taxpayer's tax rate on ordinary income is higher than for long-term capital gain.

Answer: C
Explanation: Short-term capital gains are taxed at a higher tax rate than long-term capital gains.
Diff: 1
Learning Objective: LO 1.3
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.3
Time on Task: 5 min

28) Which of the following is false?
A) Partnerships, limited liability companies, and S corporations are flow-through entities.
B) Flow-through entities pass income through to their owners, who report the income on their tax returns.
C) Corporations and individuals have similar tax rate structures.
D) The advantage of the lower corporate rate is partially offset, however, by the second level of tax on corporate income when it is distributed to a shareholder as a dividend.

Answer: C
Explanation: Corporations have a significantly different tax rate structure than individuals. Corporate taxpayers pay a flat rate of 21%, regardless of the level of income.
Diff: 1
Learning Objective: LO 1.3
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.3
Time on Task: 5 min

29) Which of the following income sources has the lowest percentage of underreporting?
A) Wages

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B) Farm income
C) Rents
D) Capital gains

Answer: A
Explanation: The percentage of underreported wages is the lowest compared to other types of income. Compliance with tax laws varies significantly across different types of income. Compliance is the highest when someone other than the taxpayer is required to report income to the IRS, such as employers who must report the wages paid to each employee to the IRS on a Form W-2.
Diff: 1
Learning Objective: LO 1.4
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.4
Time on Task: 5 min

30) Which of the following is false?
A) When the law is unclear, you must apply the most relevant tax authority that does exist to the current facts.
B) Excellent knowledge of the tax law improves confidence in your decision when dealing with complex transaction.
C) Integrity will help you discern the difference between practicing tax avoidance and slipping into tax evasion.
D) The AICPA's Code of Professional Conduct applies to all CPAs but not tax professionals.

Answer: D
Explanation: The AICPA's Code of Professional Conduct, which applies to all CPAs, including those who are tax professionals.
Diff: 1
Learning Objective: LO 1.4
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.4
Time on Task: 5 min

31) Which of the following is an example of tax evasion?
A) Duke omits reporting the capital gains on his cryptocurrency because his capital gains were

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unexpected.
B) Duke accelerates his income into Y1 when his marginal tax is lower.
C) Duke defers a tax deduction into the next year because his marginal tax is higher.
D) Duke gets married in December to take advantage of the larger standard deduction.

Answer: A
Explanation: Intentionally omitting income is tax evasion. The other options are examples of tax avoidance. Tax avoidance is structuring a transaction or arranging your financial affairs in a legal manner to maximize your after-tax income.
Diff: 1
Learning Objective: LO 1.4
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.4
Time on Task: 5 min

32) Which of the following is false?
A) The purpose of GAAP is to provide financial statements that are useful for decision making.
B) While GAAP and tax rules generally differ, they share a similarity in the timing of recognizing expenses.
C) The matching principle requires a business to record expenses incurred during the same period it recognizes the related revenue as earned.
D) The conservatism principle requires that a business recognize expenses and liabilities as soon as possible.

Answer: B
Explanation: One important area where the tax rules differ from the rules for financial reporting is the timing of recognizing expenses. The tax law does not usually allow taxpayers to estimate expenses; rather, no expense is recorded until the taxpayer knows the amount of the expense with certainty.
Diff: 1
Learning Objective: LO 1.5
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.5
Time on Task: 5 min

33) Which of the following best describes the matching principle?

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A) The matching principle requires a business to record expenses incurred during the same period it recognizes the related revenue as earned.
B) The matching principle requires a business to use the same method of revenue recognition for book and tax.
C) The matching principle requires that a business recognize expenses and liabilities as soon as possible.
D) The matching principle requires a business to match the timing of book expense recognition with tax expense recognition.

Answer: A
Explanation: The matching principle requires a business to record expenses incurred during the same period it recognizes the related revenue as earned.
Diff: 1
Learning Objective: LO 1.5
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.5
Time on Task: 5 min

34) Which of the following best describes the conservatism principle?
A) The conservatism principle requires a business to record expenses incurred during the same period it recognizes the related revenue as earned.
B) The conservatism principle requires a business to use the same method of revenue recognition for book and tax.
C) The conservatism principle requires that a business recognize expenses and liabilities as soon as possible.
D) The conservatism principle requires a business to match the timing of book expense recognition with tax expense recognition.

Answer: C
Explanation: The conservatism principle requires that a business recognize expenses and liabilities as soon as possible.
Diff: 1
Learning Objective: LO 1.5
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.5
Time on Task: 5 min

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35) Debbie runs a business that sells cell phones. Debbie reports on the accrual basis for both tax and financial reporting. In Y1, her cell phone sales totaled $1,000,000. Several of Debbie's customers typically buy on credit. As of the end of Y1, her ending accounts receivables are $450,000. Industry data shows that she will not collect 6% of the receivables. Additionally, one of Debbie's customers went through bankruptcy in Y1 and Debbie could no longer collect a receivable of $17,000. Debbie uses the allowance method for GAAP and the direct write-off method for tax. How much revenue will Debbie report for financial accounting?
A) $450,000
B) $973,000
C) $1,000,000
D) $550,000

Answer: C
Explanation: $1,000,000. Debbie will report revenue of $1,000,000 for financial reporting.
Diff: 2
Learning Objective: LO 1.5
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Application
Section Reference: Sec. 1.5
Time on Task: 5 min

36) Debbie runs a business that sells cell phones. Debbie reports on the accrual basis for both tax and financial reporting. In Y1, her cell phone sales totaled $1,000,000. Several of Debbie's customers typically buy on credit. As of the end of Y1, her ending accounts receivables are $450,000. Industry data shows that she will not collect 6% of the receivables. Additionally, one of Debbie's customers went through bankruptcy in Y1 and Debbie could no longer collect a receivable of $17,000. Debbie uses the allowance method for GAAP and the direct write-off method for tax. How much revenue will Debbie report for tax purposes?
A) $450,000
B) $973,000
C) $1,000,000
D) $550,000

Answer: C
Explanation: $1,000,000. Debbie will report revenue of $1,000,000 for tax purposes.
Diff: 2
Learning Objective: LO 1.5
AACSB / AICPA: Analytic / Accounting Competencies

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Bloom's: Application
Section Reference: Sec. 1.5
Time on Task: 5 min

37) Debbie runs a business that sells cell phones. Debbie reports on the accrual basis for both tax and financial reporting. In Y1, her cell phone sales totaled $1,000,000. Several of Debbie's customers typically buy on credit. As of the end of Y1, her ending accounts receivables are $450,000. Industry data shows that she will not collect 6% of the receivables. Additionally, one of Debbie's customers went through bankruptcy in Y1 and Debbie could no longer collect a receivable of $17,000. Debbie uses the allowance method for GAAP and the direct write-off method for tax. How much bad debt expense will Debbie report for financial reporting?
A) $27,000
B) $17,000
C) $44,000
D) $10,000

Answer: A
Explanation: $27,000. Due to the matching and conservatism principles, she will use the allowance method of reporting bad debts and record bad debt expense of $27,000 ($450,000 × 6%) for financial reporting.
Diff: 2
Learning Objective: LO 1.5
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Application
Section Reference: Sec. 1.5
Time on Task: 5 min

38) Debbie runs a business that sells cell phones. Debbie reports on the accrual basis for both tax and financial reporting. In Y1, her cell phone sales totaled $1,000,000. Several of Debbie's customers typically buy on credit. As of the end of Y1, her ending accounts receivables are $450,000. Industry data shows that she will not collect 6% of the receivables. Additionally, one of Debbie's customers went through bankruptcy in Y1 and Debbie could no longer collect a receivable of $17,000. Debbie uses the allowance method for GAAP and the direct write-off method for tax. How much bad debt expense will Debbie report for tax purposes?
A) $27,000
B) $17,000
C) $44,000
D) $10,000

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Answer: B
Explanation: $17,000. For tax purposes, Debbie will use the direct write-off method and record $17,000 bad debt expense for the specific customer that cannot pay his bill. Unlike GAAP, the tax law does not usually allow taxpayers to estimate expenses; rather, no expense is recorded until the taxpayer knows the amount of the expense with certainty.
Diff: 2
Learning Objective: LO 1.5
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Application
Section Reference: Sec. 1.5
Time on Task: 5 min

39) Debbie runs a business that sells cell phones. Debbie reports on the accrual basis for both tax and financial reporting. In Y1, her cell phone sales totaled $1,000,000. Several of Debbie's customers typically buy on credit. As of end of Y1, her ending accounts receivables are $450,000. Industry data shows that she will not collect 6% of the receivables. Additionally, one of Debbie's customers went through bankruptcy in Y1 and Debbie could no longer collect a receivable of $17,000. Debbie uses the allowance method for GAAP and the direct write-off method for tax. Assuming Debbie has no other revenue or expenses in the current year, what is Debbie's Net Income for financial reporting and Taxable Income for income tax purposes?
A) GAAP Net Income = $1,000,000; Taxable Income = $1,000,000
B) GAAP Net Income = $961,000; Taxable Income = $983,000
C) GAAP Net Income = $973,000; Taxable Income = $973,000
D) GAAP Net Income = $973,000; Taxable Income = $983,000

Answer: D
Explanation: GAAP Net Income = $973,000 ($1,000,000 - $27,000); Taxable Income = $983,000 ($1,000,000 - $17,000). Debbie will report revenue of $1,000,000 for both financial reporting and taxes. Due to the matching and conservatism principles, she will use the allowance method of reporting bad debts and record bad debt expense of $27,000 ($450,000 × 6%) for financial reporting. For tax purposes, Debbie will use the direct write-off method and record $17,000 bad debt expense for the specific customer that cannot pay his bill. Unlike GAAP, the tax law does not usually allow taxpayers to estimate expenses; rather, no expense is recorded until the taxpayer knows the amount of the expense with certainty.
Diff: 3
Learning Objective: LO 1.5
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Application

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Section Reference: Sec. 1.5
Time on Task: 10 min

40) Which of the following is not one of the five main goals that policymakers attempt to achieve with the income tax system?
A) Raise Revenue
B) Environmental Objectives
C) Social Objectives
D) Political Objectives

Answer: B
Explanation: The five main goals that policymakers attempt to achieve with the income tax system are - raise revenue, social objectives, economic objectives, equity objectives and political objectives.
Diff: 1
Learning Objective: LO 1.6
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.6
Time on Task: 5 min

41) Which of the following is false?
A) The most important role of the federal income tax is to raise revenue to support the operations of the federal government.
B) Equity in tax systems often depends on the total tax paid by an individual.
C) Bonus depreciation is an example of an economic objective.
D) Filing status and tax brackets is an example of an equity objective.

Answer: B
Explanation: Equity in tax systems often depends on whether the tax distribution is based on the ability to pay.
Diff: 1
Learning Objective: LO 1.6
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.6
Time on Task: 5 min

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42) Which of the following is not a social objective?
A) A credit is allowed for individuals with solar panels.
B) Businesses are allowed to accelerate the deduction of newly acquired assets.
C) A credit is allowed for adopting a child.
D) Mortgage interest on principal residence is deductible.

Answer: B
Explanation: When businesses are allowed to accelerate the deduction of new assets, it is not a social objective but an economic objective. Economic objectives influence economic growth.
Diff: 1
Learning Objective: LO 1.6
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.6
Time on Task: 5 min

43) Which of the following is false about social objectives?
A) When congress encourages individuals to support certain organizations by allowing taxpayers to deduct contributions, it is a social objective.
B) Tax expenditures are special provisions such as exclusions, deductions, deferrals, and credits that benefit specific activities or groups of taxpayers.
C) Charitable contributions are an example of a tax expenditure.
D) The primary purpose of social objective is to generate revenue to support operation of the federal government.

Answer: D
Explanation: The primary purpose of social objectives is not to generate revenue for the federal government. Congress encourages individuals to support certain organizations by allowing taxpayers to deduct contributions to organizations that have a purpose related to one of the following areas: charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. While less tax revenue is collected because of this deduction, taxpayer contributions reduce the funds Congress needs to allocate to support the positive contributions such organizations make to our society.
Diff: 1
Learning Objective: LO 1.6
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge

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Section Reference: Sec. 1.6
Time on Task: 5 min

44) What objective does Congress attempt to achieve by allowing individuals to deduct charitable contributions?
A) Economic
B) Social
C) Equity
D) Political

Answer: B
Explanation: Congress encourages individuals to support certain organizations by allowing taxpayers to deduct contributions to organizations that have a purpose related to one of the following areas: charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. While less tax revenue is collected because of this deduction, taxpayer contributions reduce the funds Congress needs to allocate to support the positive contributions such organizations make to our society.
Diff: 1
Learning Objective: LO 1.6
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.6
Time on Task: 5 min

45) What objective does Congress attempt to achieve by allowing businesses to accelerate the deduction for newly acquired assets?
A) Economic
B) Social
C) Equity
D) Political

Answer: A
Explanation: Another important objective of tax policy is to influence economic growth. When economic growth slows in the United States, Congress often responds with tax incentives that encourage individuals to invest in expanding their businesses. When the Great Recession began in 2008, Congress enacted 50% bonus depreciation in the 2008 Economic Stimulus Act. This permitted businesses to deduct 50% of the cost of new assets in the year of purchase, which

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allowed business owners to reduce their tax liability more quickly through accelerated deductions.
Diff: 1
Learning Objective: LO 1.6
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.6
Time on Task: 5 min

46) What objective does Congress attempt to achieve by allowing different filing status and tax brackets?
A) Economic
B) Social
C) Equity
D) Political

Answer: C
Explanation: A significant goal of tax policy is to distribute the tax burden as fairly as possible. Many tax laws exist to make the distribution of tax burdens more equitable. One example is the different filing statuses and tax brackets. Taxpayers move from one tax bracket to the next depending on their filing status and level of taxable income.
Diff: 1
Learning Objective: LO 1.6
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.6
Time on Task: 5 min

47) Which of the following is not a federal tax that raises money for the treasury?
A) Employment tax
B) Property tax
C) Excise tax
D) Transfer tax

Answer: B
Explanation: Property tax is not collected by the treasury. Property tax is collected by state and local governments.
Diff: 1

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Learning Objective: LO 1.7
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.7
Time on Task: 5 min

48) Which of the following is not a federal tax that raises money for the federal treasury?
A) Sales and use tax
B) Employment tax
C) Excise tax
D) Transfer tax

Answer: A
Explanation: Sales and use tax is not collected by the federal treasury. Sales and use tax are collected by state and local governments.
Diff: 1
Learning Objective: LO 1.7
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.7
Time on Task: 5 min

49) Which of the following is not an example of employment tax?
A) Medicare tax
B) Social Security tax
C) Excise tax
D) Self-employment tax

Answer: C
Explanation: Excise tax is not an example of employment tax. Excise taxes are similar to sales taxes but are based on the quantity purchased rather than the price of the purchase.
Diff: 1
Learning Objective: LO 1.7
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.7
Time on Task: 5 min

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50) Which of the following is an example of a tax imposed at both the federal and state level?
A) Excise tax
B) Sales and use tax
C) Employment tax
D) Transfer tax

Answer: A
Explanation: Excise taxes are similar to sales taxes but are based on the quantity purchased rather than the price of the purchase. State and local governments also impose excise taxes on some of the goods taxed at the federal level. Sales and use tax only occur at the state level. Employment and transfer tax only occurs at the federal level.
Diff: 1
Learning Objective: LO 1.7
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.7
Time on Task: 5 min

51) Which of the following is not a common graduate degree for those working in taxation?
A) Master of Science in Taxation
B) Master of Accounting with Specialization in Tax
C) Master of Public Accounting
D) L.L.M in Taxation

Answer: C
Explanation: Master of Public Accounting is not a graduate degree.
Diff: 1
Learning Objective: LO 1.8
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.8
Time on Task: 5 min

52) Samson's wages are $120,000. He lives in Maryland and his expenses include $25,900 rent, $11,500 other living expenses, $32,400 income tax, $7,440 payroll tax and $6,600 property tax. What are Samson's tax costs?

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Answer: $46,440
Explanation: $46,440 = $32,400 + $7,440 + $6,600. Tax costs include any type of tax paid to a local, state, federal, or foreign government.
Diff: 1
Learning Objective: LO 1.1
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Application
Section Reference: Sec. 1.1
Time on Task: 5 min

53) Samson's wages are $120,000. He lives in Maryland and his expenses include $25,900 mortgage interest, $11,500 other living expenses, $32,400 income tax, $7,440 payroll tax and $6,600 property tax. What is Samson's non-tax costs?

Answer: $37,400
Explanation: $37,400 = $25,900 + $11,500. Non-tax costs are all costs other than tax costs. Tax costs include any type of tax paid to a local, state, federal, or foreign government.
Diff: 1
Learning Objective: LO 1.1
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Application
Section Reference: Sec. 1.1
Time on Task: 5 min

54) Samson's wages are $120,000. He lives in Maryland and his non-tax costs include $25,900 rent and $11,500 other living expenses. His tax costs include $32,400 income tax, $7,440 payroll tax and $6,600 property tax. What is Samson's after-tax income?

Answer: $36,160
Explanation: $36,160 = $120,000 - $25,900 - $11,500 - $32,400 - $7,440 - $6,600. After-tax income is net income after reducing revenue for all expenses, including federal and state taxes.
Diff: 2
Learning Objective: LO 1.1
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Application
Section Reference: Sec. 1.1
Time on Task: 8 min

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55) Felicia lives in Utah. Felicia's gross wages are $120,000 and her expenses include $26,500 rent, $10,500 other living expenses, $32,400 income tax and $7,440 payroll tax. Sarah lives in New York. Sarah's gross wages are $140,000 and her expenses include $40,000 rent, $15,000 other living expenses, $38,500 income tax and $8,680 payroll tax. What is Felicia's after-tax income?

Answer: $43,160
Explanation: $43,160 = $120,000 - $26,500 - $10,500 - $32,400 - $7,440
Diff: 2
Learning Objective: LO 1.1
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Application
Section Reference: Sec. 1.1
Time on Task: 8 min

56) Felicia lives in Utah. Felicia's gross wages are $120,000 and her expenses include $26,500 rent, $10,500 other living expenses, $32,400 income tax and $7,440 payroll tax. Sarah lives in New York. Sarah's gross wages are $140,000 and her expenses include $40,000 rent, $15,000 other living expenses, $38,500 income tax and $8,680 payroll tax. What is Sarah's after-tax income?

Answer: $37,820
Explanation: $37,820 = $140,000 - $40,000 - $15,000 - $38,500 - $8,680
Diff: 2
Learning Objective: LO 1.1
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Application
Section Reference: Sec. 1.1
Time on Task: 8 min

57) Felicia lives in Utah. Felicia's gross wages are $120,000 and her expenses include $26,500 rent, $10,500 other living expenses, $32,400 income tax and $7,440 payroll tax. Sarah lives in New York. Sarah's gross wages are $140,000 and her expenses include $40,000 rent, $15,000 other living expenses, $38,500 income tax and $8,680 payroll tax. Who has the higher after-tax income?

Answer: Felicia

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Explanation: Felicia.

	Felicia	Sarah
Wages	120,000	140,000
Rent	(26,500)	(40,000)
Other Living expenses	(10,500)	(15,000)
Income Tax	(32,400)	(38,500)
Payroll Tax	(7,440)	(8,680)
After-Tax Income	**43,160**	**37,820**

Diff: 2
Learning Objective: LO 1.1
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Application
Section Reference: Sec. 1.1
Time on Task: 8 min

58) Tariq has a mortgage interest credit of $1,550, unemployment compensation of $650, and taxable state refund of $3,250. What is the total amount to be reported on schedule 3 of the 1040?

Answer: $1,550
Explanation: $1,550. The mortgage interest credit is reported on Schedule 3 while the Taxable State refund and unemployment compensation are reported on Schedule 1. Schedule 1 is used to report additional income and adjustments to income. Schedule 2 is used to report additional taxes. Schedule 3 is used to report additional payments and credits.
Diff: 2
Learning Objective: LO 1.2
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.2
Time on Task: 5 min

59) Tariq has a mortgage interest credit of $1,550, unemployment compensation of $650, and taxable state refund of $3,250. What is the total amount to be reported on schedule 1 of the 1040?

Answer: $3,900
Explanation: $3,900 = $3,250 + $650. The mortgage interest credit is reported on Schedule 3 while the Taxable State refund and unemployment compensation are reported on Schedule 1.

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Schedule 1 is used to report additional income and adjustments to income. Schedule 2 is used to report additional taxes. Schedule 3 is used to report additional payments and credits.
Diff: 2
Learning Objective: LO 1.2
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.2
Time on Task: 5 min

60) Shanice has a mortgage interest credit of $2,400, unemployment compensation of $700, taxable state refund of $5,000 and received an alimony payment of $15,000. What is the total amount to be reported on schedule 1 of the 1040?

Answer: $20,700
Explanation: $20,700 = $15,000 + $5,000 + $700. The mortgage interest credit is reported on Schedule 3 while the Taxable State refund, unemployment compensation and alimony are reported on Schedule 1. Schedule 1 is used to report additional income and adjustments to income. Schedule 2 is used to report additional taxes. Schedule 3 is used to report additional payments and credits.
Diff: 2
Learning Objective: LO 1.2
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.2
Time on Task: 5 min

61) Sharon has a total income of $1,500,000, taxable income of $800,000 and a tax liability of $200,000. Each additional dollar of deduction will save her 37 cents in taxes. What is Sharon's marginal tax rate?

Answer: 37%
Explanation: Marginal tax rate = 37% (0.37 / 1). Marginal tax rate is the tax rate applied to the next additional dollar of income earned.
Diff: 2
Learning Objective: LO 1.3
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Analysis
Section Reference: Sec. 1.3

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Time on Task: 8 min

62) Sharon has a total income of $1,500,000, taxable income of $900,000 and a tax liability of $270,000. Each additional dollar of deduction will save her 37 cents in taxes. What is Sharon's average tax rate?

Answer: 30%
Explanation: Average tax rate = 30% = ($270,000 / $900,000). Average Tax rate is total income tax divided by taxable income.
Diff: 2
Learning Objective: LO 1.3
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Analysis
Section Reference: Sec. 1.3
Time on Task: 8 min

63) Sharon has a total income of $1,500,000, taxable income of $900,000 and a tax liability of $270,000. Each additional dollar of deduction will save her 37 cents in taxes. What is Sharon's effective tax rate?

Answer: 18%
Explanation: Effective tax rate = 18% ($270,000 / $1,500,000). Effective tax rate is the total income tax divided by total income.
Diff: 2
Learning Objective: LO 1.3
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Analysis
Section Reference: Sec. 1.3
Time on Task: 8 min

64) Daniel has a total income of $240,000 and taxable income of $210,000. Assuming he files as a single filer and the table below applies to him. What is Daniel's tax liability?

If Taxable Income is:	The Tax Is:
Not Over $11,925	10% of the taxable income
Over $11,925 but not over $48,475	$1,192.50 plus 12% of excess over $11,925
Over $48,475 but not over $103,350	$5,578.50 plus 22% of excess over $48,475
Over $103,350 but not over $197,300	$17,651 plus 24% of excess over $103,350

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Over $197,300 but not over $250,525	$40,199 plus 32% of excess over $197,300
Over $250,525 but not over $626,350	$57,231 plus 35% of excess over $250,525
Over $626,350	$188,769.75 plus 37% of excess over $626,350

Answer: $44,263
Explanation:

Taxable Income	$ 210,000
Less: Threshold for 32% tax bracket	$ (197,300)
Income taxed at 32%	$ 12,700
	× 32%
	$ 4,064.00
Plus: Tax on $197,300	$ 40,199.00
Tax Liability	***$ 44,263.00***

Diff: 2
Learning Objective: LO 1.3
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Analysis
Section Reference: Sec. 1.3
Time on Task: 8 min

65) Daniel has a total income of $240,000 and taxable income of $210,000. Assuming he files as a single filer and the table below applies to him. What is Daniel's marginal tax rate?

If Taxable Income is:	The Tax Is:
Not Over $11,925	10% of the taxable income
Over $11,925 but not over $48,475	$1,192.50 plus 12% of excess over $11,925
Over $48,475 but not over $103,350	$5,578.50 plus 22% of excess over $48,475
Over $103,350 but not over $197,300	$17,651 plus 24% of excess over $103,350
Over $197,300 but not over $250,525	$40,199 plus 32% of excess over $197,300
Over $250,525 but not over $626,350	$57,231 plus 35% of excess over $250,525
Over $626,350	$188,769.75 plus 37% of excess over $626,350

Answer: 32%
Explanation: Daniel's taxable income is $210,000, which falls within the 32% tax bracket. Daniel's marginal tax rate is 32%. The marginal tax rate is the tax rate applied to the next additional dollar of income earned.
Diff: 2
Learning Objective: LO 1.3
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Analysis

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Section Reference: Sec. 1.3
Time on Task: 8 min

66) Daniel has a total income of $240,000 and taxable income of $210,000. Assuming he files as a single filer and the table below applies to him. What is Daniel's average tax rate?

If Taxable Income is:	The Tax Is:
Not Over $11,925	10% of the taxable income
Over $11,925 but not over $48,475	$1,192.50 plus 12% of excess over $11,925
Over $48,475 but not over $103,350	$5,578.50 plus 22% of excess over $48,475
Over $103,350 but not over $197,300	$17,651 plus 24% of excess over $103,350
Over $197,300 but not over $250,525	$40,199 plus 32% of excess over $197,300
Over $250,525 but not over $626,350	$57,231 plus 35% of excess over $250,525
Over $626,350	$188,769.75 plus 37% of excess over $626,350

Answer: 21.08%
Explanation:

Taxable Income	$	210,000
Less: Threshold for 32% tax bracket	$	(197,300)
Income taxed at 32%	$	12,700
		× 32%
	$	4,064.00
Plus: Tax on $197,300	$	40,199.00
Tax Liability	$	44,263.00

Average Tax Rate = $\frac{\textbf{Total Income Tax (\$44,263)}}{\textbf{Total Income (\$210,000)}}$ = **21.08%**

Diff: 2
Learning Objective: LO 1.3
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Analysis
Section Reference: Sec. 1.3
Time on Task: 8 min

67) Daniel has a total income of $240,000 and taxable income of $210,000. Assuming he files as a single filer and the table below applies to him. What is Daniel's effective tax rate?

If Taxable Income is:	The Tax Is:
Not Over $11,925	10% of the taxable income
Over $11,925 but not over $48,475	$1,192.50 plus 12% of excess over $11,925
Over $48,475 but not over $103,350	$5,578.50 plus 22% of excess over $48,475

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Over $103,350 but not over $197,300	$17,651 plus 24% of excess over $103,350
Over $197,300 but not over $250,525	$40,199 plus 32% of excess over $197,300
Over $250,525 but not over $626,350	$57,231 plus 35% of excess over $250,525
Over $626,350	$188,769.75 plus 37% of excess over $626,350

Answer: 18.44%
Explanation:

Taxable Income	$	210,000
Less: Threshold for 32% tax bracket	$	(197,300)
Income taxed at 32%	$	12,700
		× 32%
	$	4,064.00
Plus: Tax on $197,300	$	40,199.00
Tax Liability	$	44,263.00

Effective Tax Rate = $\frac{\text{Total Income Tax (\$44,263)}}{\text{Total Income (\$240,000)}}$ = **18.44%**

Diff: 2
Learning Objective: LO 1.3
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Analysis
Section Reference: Sec. 1.3
Time on Task: 8 min

68) Jessica has received several job offers from various accounting firms located in 4 different states. She has performed an analysis to determine her income, her non-income tax costs (e.g. cost of living, etc.) and income tax. Jessica is trying to make a decision on which offer to accept, and she has asked for your advice. What is Jessica's after-tax income in each state?

	Gross Wages	Non-Income Tax Costs	Income Tax
California	125,000	53,750	25,000
New York	110,000	40,700	22,000
Virginia	80,000	12,300	12,000
Texas	60,000	7,200	6,000

Answer:

	Gross Wages (A)	Non-Income Tax Costs (B)	Income Tax (C)	After-Tax Income (D) = (A) - (B) - (C)
California	125,000	53,750	25,000	46,250
New York	110,000	40,700	22,000	47,300

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Virginia	80,000	12,300	12,000	55,700
Texas	60,000	7,200	6,000	46,800

Explanation: After-tax income is net income after reducing revenue for all expenses, including federal income taxes. The appropriate goal for tax planning is to maximize after-tax income. See table below for calculation of after-tax income for each state.
Diff: 2
Learning Objective: LO 1.1
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Application
Section Reference: Sec. 1.1
Time on Task: 10 min

69) Jessica has received several job offers from various accounting firms located in 4 different states. She has performed an analysis to determine her income, her non-income tax costs (e.g., cost of living, etc.) and income tax. Jessica is trying to make a decision on which offer to accept, and she has asked for your advice. Based on the appropriate goal of tax planning, which of the following states would you advise Jessica to choose?

	Gross Wages	Non-Income Tax Costs	Income Tax
California	125,000	53,750	25,000
New York	110,000	40,700	22,000
Virginia	80,000	12,300	12,000
Texas	60,000	7,200	6,000

Answer: Virginia
Explanation: Virginia. The appropriate goal for tax planning is to maximize after-tax income. After-tax income is net income after reducing revenue for all expenses, including federal income taxes. Virginia. See table below for calculation of after-tax income for each state. With that in mind, you should advise Jessica to choose Virginia because doing so maximizes her after-tax income. The state with the lowest income tax (i.e., Texas) is not the right answer because minimizing a taxpayer's liability is not the appropriate goal for tax planning because if that were the goal, then the ultimate success would be to reduce a taxpayer's tax liability to zero–actually an easy goal to meet. If a taxpayer has no income for the year, then there will be no tax liability, and you will have minimized their taxes. But your client will also be a very poor and hungry person, so this cannot be the proper goal.

	Gross Wages (A)	Non-Income Tax Costs (B)	Income Tax (C)	After-Tax Income (D) = (A) - (B) - (C)
California	125,000	53,750	25,000	46,250

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New York	110,000	40,700	22,000	47,300
Virginia	80,000	12,300	12,000	**55,700**
Texas	60,000	7,200	6,000	46,800

Diff: 2
Learning Objective: LO 1.1
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Application
Section Reference: Sec. 1.1
Time on Task: 10 min

70) The tax rates below are used for tax planning or decision making:
A. Marginal Tax Rate
B. Average Tax Rate
C. Effective Tax Rate
The following is a description of each of the tax rates above. Match each description below to the tax rate above by placing the appropriate letter in the blank space next to each description.
_____ 1. Total income tax divided by total income.
_____ 2. Applied to the next additional dollar of income earned.
_____ 3. Total income tax divided by taxable income.

Answer: 1. C 2. A 3. B
Explanation: Effective tax rate is the total income tax divided by total income. Marginal tax rate is the tax rate applied to the next additional dollar of income earned. Average Tax rate is total income tax divided by taxable income.
Diff: 1
Learning Objective: LO 1.3
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge, Comprehension
Section Reference: Sec. 1.3
Time on Task: 5 min

71) Below are definitions related to tax planning. Fill in the blank with the word(s) that best describes the sentences below:
a) This tax planning strategy assumes that the tax collected always increases as the rate increases, and that the variables are independent of one another. _____
b) This tax planning strategy assumes there is a relationship between the tax base and the tax rate. _____
c) This tax planning strategy predicts taxpayers respond to increased taxes by working more

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hours to generate the same after-tax income. _____
d) This tax planning strategy predicts that taxpayers respond to increased taxes by working fewer hours. _____

Answer: a) Static forecasting b) Dynamic forecasting c) Income effect d) Substitution effect
Explanation: Static forecasting assumes that the tax collected always increases as the rate increases, and that the variables are independent of one another. Dynamic forecasting assumes there is a relationship between the tax base and the tax rate. Income effect predicts taxpayers respond to increased taxes by working more hours to generate the same after-tax income. Substitution effect predicts that taxpayers respond to increased taxes by working fewer hours.
Diff: 1
Learning Objective: LO 1.3
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge, Comprehension
Section Reference: Sec. 1.3
Time on Task: 5 min

72) Indicate the most likely objective — social, economic, or equity — that policymakers would meet with each tax law:
a) A credit is allowed for individuals with solar panels
b) Businesses are allowed to accelerate the deduction of newly acquired assets
c) Individuals are allowed to deduct expenses to charitable organizations
c) Taxpayers move from one tax bracket to the next depending on their taxable income

Answer: a) social b) economic c) social d) equity
Explanation: a) social b) economic c) social d) equity. Social objective aims to encourage taxpayers to support certain organizations by providing taxpayers with a deduction. Economic objectives aim to influence economic growth. Equity objective aims to make the distribution of tax burdens more equitable.
Diff: 1
Learning Objective: LO 1.6
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Application
Section Reference: Sec. 1.6
Time on Task: 5 min

73) Fill in the blank with the tax structure that best describes the sentences below:
a) When the marginal tax rate decreases as the tax base increases, the tax structure is _____.

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b) When all taxpayers pay the same tax rate, the tax structure is _____.
c) When the marginal tax rate increases as the tax base increases, the tax structure is _____.

Answer: a) Regressive; b) Proportional; c) Progressive
Explanation: a) Regressive; b) Proportional; c) Progressive
Diff: 1
Learning Objective: LO 1.6
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.6
Time on Task: 5 min

74) Stacy is a single filer. Her taxable income is $275,000. Her total income is $325,000. The applicable tax rate schedule for Stacy is:

If Taxable Income is:	The Tax Is:
Over $250,525 but not over $626,350	$57,231 plus 35% of excess over $250,525

Compute Stacy's tax liability, average tax rate, and effective tax rate.

Answer: Tax Liability = $65,797.25; Average tax rate = 23.93%; Effective tax rate = 20.25%
Explanation:

Taxable Income	$	275,000
Less: Threshold for 35% tax bracket	$	(250,525)
Income taxed at 35%	$	24,475
		× 35%
	$	8.566.25
Plus: Tax on $250,525	$	57,231.00
Tax Liability	***$***	***65,797.25***

Average Tax Rate = $\frac{\textbf{Total Income Tax (\$65,797.25)}}{\textbf{Total Income (\$275,000)}}$ = **23.93%**

Effective Tax Rate = $\frac{\textbf{Total Income Tax (\$65,797.25)}}{\textbf{Total Income (\$325,000)}}$ = **20.25%**

Diff: 3
Learning Objective: LO 1.3
AACSB / AICPA: Analytic / Accounting Competencies
Bloom's: Analysis
Section Reference: Sec. 1.3
Time on Task: 15 min

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75) Describe why financial accounting rules and tax rules differ.

Answer: Financial accounting rules and tax rules differ because they exist for very different purposes. The purpose of GAAP is to provide financial statements that are useful for decision-making by investors, creditors, employees, and other users of the information. To be useful, the statements must be relevant. To be relevant, businesses must adhere to certain principles. The matching principle requires a business to record expenses incurred during the same period it recognizes the related revenue as earned. This ensures that the business does not overstate its income. The conservatism principle requires that a business recognize expenses and liabilities as soon as possible, even when there is some uncertainty about the existence of the liability but recognize revenues and assets only when they are assured of being received. Because outside investors rely on financial statements to make important decisions, these principles protect public trust. The main purpose of the tax laws, by contrast, is to generate revenue to fund the federal government. (We will discuss additional goals later in this chapter.) This is a very different purpose from providing financial information useful for decision-making to investors. One important area where the tax rules differ from the rules for financial reporting is the timing of recognizing expenses. The tax law does not usually allow taxpayers to estimate expenses; rather, no expense is recorded until the taxpayer knows the amount of the expense with certainty.
Diff: 1
Learning Objective: LO 1.5
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.5
Time on Task: 5 min

76) Briefly describe why the IRS is a potential third party to every financial transaction.

Answer: The IRS is a potential uninvited third party to every financial transaction because there is a potential tax effect for every transaction engaged in by an individual.
Explanation: The IRS is a potential uninvited third party to every financial transaction because there is a potential tax effect for every transaction engaged in by an individual.
Diff: 1
Learning Objective: LO 1.1
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.1
Time on Task: 5 min

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77) Briefly define after-tax income.

Answer: After-tax income is net income after reducing revenue for all expenses, including federal income taxes.
Explanation: After-tax income is net income after reducing revenue for all expenses, including federal income taxes.
Diff: 1
Learning Objective: LO 1.1
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.1
Time on Task: 5 min

78) What Schedule of the Form 1040 is mortgage interest credit reported?

Answer: Schedule 3
Explanation: The mortgage interest credit is reported on Schedule 3. Schedule 3 is used to report additional payments and credits. Schedule 1 is used to report additional income and adjustments to income. Schedule 2 is used to report additional taxes.
Diff: 2
Learning Objective: LO 1.2
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.2
Time on Task: 5 min

79) What Schedule of the Form 1040 is taxable refund reported?

Answer: Schedule 1
Explanation: Taxable State refund and unemployment compensation are reported on Schedule 1. Schedule 1 is used to report additional income and adjustments to income. Schedule 2 is used to report additional taxes. Schedule 3 is used to report additional payments and credits.
Diff: 2
Learning Objective: LO 1.2
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.2
Time on Task: 5 min

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80) What Schedule of Form 1040 is used to report additional income and adjustments to income?

Answer: Schedule 1
Explanation: Schedule 1 is used to report additional income and adjustments to income. Schedule 2 is used to report additional taxes. Schedule 3 is used to report additional payments and credits.
Diff: 2
Learning Objective: LO 1.2
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.2
Time on Task: 5 min

81) What Schedule of Form 1040 is used to report additional taxes?

Answer: Schedule 2
Explanation: Schedule 2 is used to report additional taxes. Schedule 1 is used to report additional income and adjustments to income. Schedule 3 is used to report additional payments and credits.
Diff: 2
Learning Objective: LO 1.2
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.2
Time on Task: 5 min

82) What Schedule of Form 1040 is used to report payments and credits?

Answer: Schedule 3
Explanation: Schedule 3 is used to report additional payments and credits. Schedule 2 is used to report additional taxes. Schedule 1 is used to report additional income and adjustments to income.
Diff: 2
Learning Objective: LO 1.2
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge

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Section Reference: Sec. 1.2
Time on Task: 5 min

83) Briefly describe Tax Compliance.

Answer: Tax compliance determines the tax effects for transactions that have already occurred, including the preparation of tax returns.
Explanation: Tax compliance determines the tax effects for transactions that have already occurred, including the preparation of tax returns.
Diff: 1
Learning Objective: LO 1.3
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.3
Time on Task: 5 min

84) Briefly describe Tax Planning.

Answer: Tax planning is the process of estimating an individual's tax liability for multiple scenarios and/or multiple years and considering ways to maximize after-tax income.
Explanation: Tax planning is the process of estimating an individual's tax liability for multiple scenarios and/or multiple years and considering ways to maximize after-tax income.
Diff: 1
Learning Objective: LO 1.3
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.3
Time on Task: 5 min

85) Briefly describe closed transaction.

Answer: A closed transaction is one where the relevant events have already happened, and the facts are set. The tax professional completes the compliance process by determining how the tax law applies to the facts and the manner reported on the tax return.
Explanation: A closed transaction is one where the relevant events have already happened, and the facts are set. The tax professional completes the compliance process by determining how the tax law applies to the facts and the manner reported on the tax return.

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Diff: 1
Learning Objective: LO 1.3
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.3
Time on Task: 5 min

86) Briefly describe open transaction and why it is preferable for a tax professional.

Answer: An open transaction is a transaction that is not yet completed. A tax professional prefers an open transaction because the tax professional can consider a range of options for structuring the transaction and choose the one that has the best tax results for his/her client.
Explanation: An open transaction is a transaction that is not yet completed. A tax professional prefers an open transaction because the tax professional can consider a range of options for structuring the transaction and choose the one that has the best tax results for his/her client.
Diff: 1
Learning Objective: LO 1.3
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.3
Time on Task: 5 min

87) What is the concept of time value of money?

Answer: The time value of money is the concept that funds available today are worth more than the identical sum in the future due to their earnings potential if the funds are invested. The time value of money presents tax planning opportunities even when there is no change in tax rates across varying time periods, jurisdictions, types of income, or types of taxpayers.
Explanation: The time value of money is the concept that funds available today are worth more than the identical sum in the future due to their earnings potential if the funds are invested. The time value of money presents tax planning opportunities even when there is no change in tax rates across varying time periods, jurisdictions, types of income, or types of taxpayers.
Diff: 1
Learning Objective: LO 1.3
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.3
Time on Task: 5 min

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88) Briefly describe tax avoidance.

Answer: Tax avoidance is structuring a transaction or arranging your financial affairs in a legal manner to maximize your after-tax income.
Explanation: Tax avoidance is structuring a transaction or arranging your financial affairs in a legal manner to maximize your after-tax income.
Diff: 1
Learning Objective: LO 1.4
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.4
Time on Task: 5 min

89) Briefly describe tax evasion.

Answer: Tax evasion is reducing your tax liability illegally.
Explanation: Tax evasion is reducing your tax liability illegally.
Diff: 1
Learning Objective: LO 1.4
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.4
Time on Task: 5 min

90) Briefly describe a regressive tax structure.

Answer: A regressive tax structure is when the marginal tax rate decreases as the tax base increases.
Explanation: A regressive tax structure is when the marginal tax rate decreases as the tax base increases.
Diff: 1
Learning Objective: LO 1.6
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.6
Time on Task: 5 min

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91) Briefly describe a proportional tax structure.

Answer: A proportional tax structure is when all taxpayers pay the same tax rate.
Explanation: A proportional tax structure is when all taxpayers pay the same tax rate.
Diff: 1
Learning Objective: LO 1.6
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.6
Time on Task: 5 min

92) Briefly describe a progressive tax structure.

Answer: A progressive tax structure is when marginal tax rate increases as the tax base increases.
Explanation: A progressive tax structure is when marginal tax rate increases as the tax base increases.
Diff: 1
Learning Objective: LO 1.6
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.6
Time on Task: 5 min

93) What is the difference between horizontal and vertical equity?

Answer: Horizontal equity means that taxpayers in similar situations should pay similar amounts of tax while vertical equity means that those with greater ability to bear the tax burden pay more in taxes than those with less ability to pay.
Explanation: Horizontal equity means that taxpayers in similar situations should pay similar amounts of tax while vertical equity means that those with greater ability to bear the tax burden pay more in taxes than those with less ability to pay.
Diff: 1
Learning Objective: LO 1.6
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge

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Section Reference: Sec. 1.6
Time on Task: 5 min

94) Briefly describe explicit tax.

Answer: An explicit tax is a tax paid to various levels of the government, such as income taxes or sales taxes.
Explanation: An explicit tax is a tax paid to various levels of the government, such as income taxes or sales taxes.
Diff: 1
Learning Objective: LO 1.7
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.7
Time on Task: 5 min

95) Briefly describe implicit tax.

Answer: Implicit taxes are not actually taxes, nor are they paid to the government. Instead, they are costs imposed on an individual due to a tax advantage that the government has given a particular transaction.
Explanation: Implicit taxes are not actually taxes, nor are they paid to the government. Instead, they are costs imposed on an individual due to a tax advantage that the government has given a particular transaction.
Diff: 1
Learning Objective: LO 1.7
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.7
Time on Task: 5 min

96) List 4 different taxes that raise money for the treasury.

Answer: Income tax, Employment tax, Excise tax, Transfer tax
Explanation: Income tax, Employment tax, Excise tax, Transfer tax
Diff: 1
Learning Objective: LO 1.7

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AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.7
Time on Task: 5 min

97) List 4 different taxes that raises money for state and local governments.

Answer: Income tax, Sales and Use tax, Property tax, Excise tax
Explanation: Income tax, Sales and Use tax, Property tax, Excise tax
Diff: 1
Learning Objective: LO 1.7
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.7
Time on Task: 5 min

98) List 4 areas that tax professionals can add value to.

Answer: Business tax services, financial services, State and local tax compliance, and Mergers and Acquisition
Explanation: Business tax services • Financial services • Private wealth consulting • Estate planning • International tax • State and local taxation • Tax compliance • Representing clients that have tax controversies • Mergers and acquisitions
Diff: 1
Learning Objective: LO 1.7
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.7
Time on Task: 5 min

99) List 5 other certifications that an accounting graduate may obtain.

Answer: Certified Public Accountant, Certified Financial Planner; Certified Estate Planner; Enrolled Agent; Certified Information Systems Analyst
Explanation: Certified Public Accountant, Certified Financial Planner; Certified Estate Planner; Enrolled Agent; Certified Information Systems Analyst
Diff: 1

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Learning Objective: LO 1.8
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.8
Time on Task: 5 min

100) List 4 common graduate degrees for those working in taxation.

Answer: Master of Science in Taxation; Master of Accounting with Specialization in Tax; Doctor of Jurisprudence (J.D); L.L.M in Taxation
Explanation: The most common undergraduate degree for an entry-level position in taxation is an accounting degree. Common graduate degrees for those working in taxation, Master of Science in Taxation; Master of Accounting with Specialization in Tax; Doctor of Jurisprudence (J.D); L.L.M in Taxation.
Diff: 1
Learning Objective: LO 1.8
AACSB / AICPA: Knowledge / Accounting Competencies
Bloom's: Knowledge
Section Reference: Sec. 1.8
Time on Task: 5 min

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