

**WILLIAM AND MARILYN MATHEWS**

**Released as of November 1994**

The alphabetical answer was provided by the CFP Board and is used with permission.

Explanations have been added to the answers, all prepared by or under the direction of Michael A. Dalton and James F. Dalton, the authors, and are not part of the CFP Board's materials.

1. E	5. A	9. B	13. C	17. D
2. A	6. C	10. D	14. A	18. E
3. A	7. D	11. E	15. C	19. A
4. C	8. D	12. deleted	16. E	

Certified Financial Planner Board of Standards Inc. owns the certification marks CFP®, CERTIFIED FINANCIAL PLANNER™ and CFP (with flame logo)®, which it awards to individuals who successfully complete initial and ongoing certification requirements.

**Tax - Installment Sale (easy)**

**1. E**

The return of capital portion is determined by the gross profit percentage of this installment sale. Since it is the down payment, there is no income component. There is, however, a portion of capital gain.

Selling Price    \$1.5  
Basis            \$7  
Capital Gain    \$8  
 $\$7 \div \$15 = 46.67\%$  return of capital  
 $\$8 \div \$15 = 53.33\%$  capital gain

**Fundamentals - Time Value Calculations (moderate)**

**2. A**

N        =        120 (10 x 12)  
i        =        0.8333 (10 ÷ 12)  
PV       =        \$1,200,000  
PMT    =        \$15,858 x 5 = \$79,290 ordinary annuity as of July 1, 1993 for 5 months.

**Note:** Installment payments are generally ordinary annuities not annuities due.

Below is the CFP Board of Examiner's response to a candidate's question regarding this exam item:

*#2 is based on a sale price of \$1.5 million with a down payment of \$300,000, leaving a balance of \$1.2 million. Payments are for 120 months at an interest rate of 0.83% per month (10% divided by 12). By the end of 1993, Bill will have received five payments. The answer to the question can be arrived through normal annuity calculation. I would agree that it probably should be calculated as an annuity due, in which case, the answer would have been slightly different, the amount of \$78,635. Even if calculated this way, clearly the closest and best answer would be A.*

**Tax - Installment Sale (difficult)**

**3. A**

Total 1993 payments  $\$15,858.09 \times 5 = \$79,290.45$

Balance of Liability as of 12/31/93

Interest is \$49,507.74 (See Amortization table)

Principal reduction was \$29,782.71

<u>Balance</u>	<u>Principal</u>	<u>Interest</u>	<u>Payment</u>
\$1,200,000.00	\$5,858.09	\$10,000.00	\$15,858.09
\$1,194,141.91	\$5,906.91	\$9,951.18	\$15,858.09
\$1,184,235.00	\$5,956.13	\$9,901.96	\$15,858.09
\$1,182,278.87	\$6,005.77	\$9,852.32	\$15,858.09
\$1,176,273.10	\$6,055.81	\$9,802.28	\$15,858.09
<b>\$1,170,217.29</b>	<b>\$29,782.71</b>	<b>\$49,507.74</b>	<b>\$79,290.45</b>

Below is the CFP Board of Examiner's response to a candidate's question regarding this exam item:

*Installment Note - \$1,200,000*

*Monthly payment - \$15,858.09*

*# of payments in 1993 - 5*

*Installment note balance as of 12-31-93 - \$1,170,217.29*

*Total 1993 Principal payments - \$29,782.71*

*Total 1993 interest payments - \$49,507.74*

Certified Financial Planner Board of Standards Inc. owns the certification marks CFP®, CERTIFIED FINANCIAL PLANNER™ and CFP (with flame logo)®, which it awards to individuals who successfully complete initial and ongoing certification requirements.

**Retirement - Social Security (moderate)**

4. **C**

The interest income from the installment sale will increase modified AGI. The sale of an asset or an installment basis is not earned income and, therefore, will not affect the collection of Social Security retirement benefits. The test is earned income. A, D, and E are incorrect. B is incorrect, because his Social Security benefits will be taxed. C is correct.

**Retirement - 401(k) Distributions (moderate)**

5. **A**

Bill and Marilyn can make rollovers, so statement #2 is correct. They can also elect 10-year averaging making statement #1 correct. They also could elect 5-year averaging making statement #4 correct. Bill cannot use 5-year averaging and have a partial rollover.

**Estates - Life Insurance in Estates (moderate)**

6. **C**

The objective is to provide estate liquidity at the death of the second spouse. Obviously inclusion in the estate of the second to die is undesirable. Statement #1 is incorrect, making A and E incorrect. Statement #2 is incorrect because of the 3-year throwback rule, making B and D incorrect. Statement #4 is a revocable trust and, therefore, would cause inclusion due to incident of ownership.

**Insurance – Annuities (difficult)**

7. **D**

The annuity starting date is unknown.

This withdrawal would appear to be a non-periodic type payment.

D is correct if this contract was entered into before August 14, 1982. It is clear when the annuity was purchased January 1, 1981.

Below is the CFP Board of Examiner's response to a candidate's question regarding this exam item:

*See IRS publication 575, which is on point.*

**Tax – Section 1244 Stock (moderate)**

8. **D**

Sale of Section 1244 stock will result in an ordinary loss of \$51,000 assuming married filing jointly.

**Estates – Planning (easy)**

9. **B**

Statements #1, #2, and #3. Bill has already agreed to sell the business on an installment basis. Any of statements #1, #2 or #3 could be effective for estate planning. Preferred stock recapitalization is a technique that is no longer available under the current Internal Revenue Code.

**Tax – Bonds (moderate)**

10. **D**

T-Bills only pay income at maturity because they are bought at a discount. Therefore, statement #4 is correct. Statement #1 is incorrect because appreciation of a municipal bond is taxable. Those two eliminate A and E. Savings bonds are not subject to state income tax; therefore, B is eliminated. D must be chosen. Statement #2 is false because the SPDA is a pre '82 SPDA.

**Estates - Gross Estate (easy)**

11. **E**

This does not even require a reading of the case except to verify that children and grandchildren exist. Statements #1 - #4 will each reduce their gross estate.

12. **Deleted**

The CFP Board of Examiner's has eliminated this question and answer.

**Retirement – Plans (difficult)**

13. **C**

Statement #1 is wrong, because it does not shelter current taxable income except to the extent of earnings on such an IRA. Statements #2, #3, and #4 are correct, except statement #4 should be modified to read "Schedule C income less 1/2 Social Security".

**Investments – Integration (moderate)**

14. **A**

A review of the balance sheet and investment portfolio supplement reveals excessive liquidity (T-Bills), a lack of growth orientation (common stocks), a lack of marginal diversification and low tax advantaged investments. E, C, and B can be quickly eliminated. D fails due to large income. A is the answer by deduction.

**Estates - Installment Sales (moderate)**

15. **C**

The question could have stated “gross estate” instead of just “estate”, but the value of the installment notes is the present value and would be included in the gross estate. It would then qualify for the marital deduction based on the simple wills.

**Estate – Weaknesses (difficult)**

16. **E**

Statement #1 is correct, because they have simple wills. Statement #2 is correct due to titling of assets. Statement #3 is correct due to lack of durable powers, trusts, and living wills. Statement #4 is correct, because financials do not indicate clear ownership interest.

Below is the CFP Board of Examiner’s response to a candidate’s question regarding this exam item:

*(4) would be correct since there is no indication on the statement of financial position as to who holds title to many of the assets. This is what is meant by “failure to coordinate titling of assets with documentation.”*

**Investments - Asset Allocation (difficult)**

17. **D**

The current economic environment is not conducive to substantive growth in equities. However, the Mathews should begin to increase their equity positions to provide additional growth. Review the economic environment. Nominal interest rates are low while real long-term rates are high. This would not be a good time to invest in long-term bonds.

**Investments - Asset Allocation (moderate)**

18. **E**

The Mathews need to increase their equity holdings. None of the answers are consistent with this strategy. Long-term fixed income securities should not be bought at this time.

**Investments - Asset Allocation (moderate)**

19. **A**

A is the only one that meets the needs of the Mathews. B is incorrect because none of the funds are passive. C has too much risk with 50% in gold. D contains 70% in very aggressive funds - too risky for the Mathews.

**MARILYN AND STUART KINCAID**

**Released as of December 1996**

The alphabetical answer was provided by the CFP Board and is used with permission.

Explanations have been added to the answers, all prepared by or  
under the direction of Michael A. Dalton and James F. Dalton, the authors,  
and are not part of the CFP Board's materials.

1. D	4. C	7. E	10. C	13. B
2. C	5. B	8. D	11. D	14. A
3. C	6. D	9. E	12. E	15. D

Certified Financial Planner Board of Standards Inc. owns the certification marks CFP®, CERTIFIED FINANCIAL PLANNER™ and CFP (with flame logo)®, which it awards to individuals who successfully complete initial and ongoing certification requirements.

**Fundamentals - Time Value of Money (moderate)**

1.

**D**

$$\begin{aligned} PV &= \$2,499,000 (\$480,000 + \$2,019,000) \text{ (Invested assets plus cash equivalent)} \\ i &= 7 \\ N &= 7 \\ FV &= \$4,012,848 \approx \$4,000,000 \end{aligned}$$

**Retirement - Needs TVM (easy)**

2.

**C**

$$\begin{aligned} N &= 7 \\ i &= 5 \text{ (inflation rate)} \\ PV &= \$10,000 \text{ (provided in the case)} \\ FV &= \$14,071 \text{ (round to } \$14,100) \end{aligned}$$

The earnings rate is irrelevant to the question. The question asks for the future monthly income needed in 7 years.

**Estates - Planning Techniques (moderate)**

3.

**C**

There is no reason to equalize the estates. The other suggestions are obviously correct. Also note there is no answer containing statements #1, #2, #3, and #4.

Below is the CFP Board of Examiner's response to a candidate's question regarding this exam item:

*Concerning why technique (1) [estate equalization] is not appropriate in this situation:*

- *Stuart's estate already is large enough to take advantage of the unified credit without the necessity of Marilyn transferring assets to him.*
- *Many of Marilyn's solely owned assets are in her IRAs, her 403(b) plan, and other qualified plans. Those assets could not be transferred to Stuart without first distributing them, thus incurring a taxation and a penalty tax.*
- *The two SPDAs owned by Marilyn name the children as beneficiaries, so would not be included in Stuart's gross estate in any event, even if Marilyn predeceases him.*
- *The value of other assets owned solely by Marilyn and the value of the assets owned solely by Stuart is fairly equal already.*

**Estates - Calculation of Gross Estate (difficult)**

4.

**C**

Take total assets from the balance sheet, less Stuart's assets, less the cash value of the life insurance, plus \$950,000 of insurance on her life = \$3,502,000 rounded to \$3.5 million.

$$(\$3,949,000 - \$12,500 - \$200,000 - \$500,000 - \$235,000 - \$82,000 - \$50,000 - \$175,000 - \$90,000 - \$2,500 - \$50,000 + \$950,000)$$

**Estates - Probate Estate (moderate)**

5. **B**

All retirement assets have named beneficiaries; all joint assets have survivorship rights (add \$110,000 + \$150,000 + \$99,000 + \$3,000 + \$25,000 + \$100,000 [term insurance] = \$487,000).

**Note:** By evaluating the answers, there is only one pair which is \$100,000 (the term insurance with the estate as beneficiary) different, and the higher number, \$497,000, must be the answer.

Below is the CFP Board of Examiner's response to a candidate's question regarding this exam item:

*To calculate the amount of Marilyn's probate estate as \$487,000, Stuart is the beneficiary of Marilyn's IRAs and retirement plans. The Series E bond does not have a POD (pay on death) beneficiary specified.*

**Mixed - Areas of Concern (easy)**

6. **D**

Evaluate statement #5. It is obviously true, allowing you can eliminate A and B. Then evaluate statement #4 and eliminate C and E. D is the answer by deduction.

**Retirement - Deferring Tax (moderate)**

7. **E**

Marilyn is not allowed to do A, C, or D. Stuart cannot do B because they are covered by a qualified plan and have too high of a level of income, and he is not employed. E is the answer, and they can get a deduction for current income tax.

**Insurance - Needs (easy)**

8. **D**

Stuart has no life insurance needs. They have substantial net worth and no dependents. Income replacement is not an issue; D is the correct answer.

Below is the CFP Board of Examiner's response to a candidate's question regarding this exam item.

*Because there is no objective concerning preserving the assets for children given in the case information, there is no specific support for additional insurance on the husband's life for the purpose of paying death taxes.*

**Insurance - Disability Insurance (easy)**

9. **E**

The question asks for the combination (of two items) that is the most appropriate. Note that only two answers can be correct. Statement #4 is the best choice since she will work for 7 more years and partial disability is a possibility; statement #5 is also true. The correct answer is E.

**Insurance - Weaknesses (easy)**

10. **C**

Statement #1 is false, thus eliminating A and B. Statement #2 is true, which eliminates E. Statement #3 is true; statement #4 is false. The answer is C.

**Investments - Portfolio Allocation (moderate)**

11. **D**

Statement #1 is false. Even small allocations of equities in a retirement portfolio will help protect against purchasing power risk. However, a larger percentage would certainly be appropriate. Statement #2 is true. Statement #3 is false; high potential growth assets are always good for tax-deferred accounts. Statement #4 is false; they may need small but not major changes in asset allocation in 7 years.

**Retirement - SPDA (easy)**

12. **E**

Since Marilyn is not planning to retire and has no immediate need for cash, she should leave the SPDA intact.

**Insurance - Taxation of Single Premium Deferred Annuities (moderate)**

13. **B**

The SPDA annuity is a pre-1982 annuity, which means that amounts up to her adjusted basis can be withdrawn on a FIFO basis resulting in no tax implications. All of the other options have negative tax implications.

**Investments - Protecting Against Purchasing Power Risk (moderate)**

14. **A**

International equity funds, precious metal funds, and variable annuities are the best-suited vehicles to reduce purchasing power risk. T-bills and municipal bonds do not provide protection against purchasing power risk.

**Tax - Vacation Home (moderate)**

15. **D**

Statement #1 is false because the vacation home was rented for less than 14 days, therefore the income need not be claimed. Statement #2 is false because all mortgage interest is deductible as an itemized deduction not subject to 2%. Statement #3 is true because this is technically a second home not rental property and not a "vacation home". Statement #4 is false because the property is not rental property and Schedule E does not apply.

**JAMES AND PAT CLARKE**  
**Released as of January 1999**

The alphabetical answer was provided by the CFP Board and is used with permission.

Explanations have been added to the answers, all prepared by or  
under the direction of Michael A. Dalton and James F. Dalton, the authors,  
and are not part of the CFP Board's materials.

1. E	4. D	7. B	10. C
2. B	5. A	8. A	11. E
3. A	6. B	9. C	

Certified Financial Planner Board of Standards Inc. owns the certification marks CFP®, CERTIFIED FINANCIAL PLANNER™ and CFP (with flame logo)®, which it awards to individuals who successfully complete initial and ongoing certification requirements.

**Investments – Portfolio Risk (easy)**

1. **E**

The Clarkes have \$300,000 in cash/cash equivalents on the balance sheet that make up 60% of total assets and 75% of invested assets. There is a significant amount of exposure to purchasing power risk in their portfolio.

**Investments – Risk Tolerance (easy)**

2. **B**

Investment in R&D partnership is clearly an inappropriate investment based on their level of risk tolerance.

**Investments - Diversification (medium)**

3. **A**

The Clarkes have no equity exposure in their portfolio (except XYZ Corporation); it would be appropriate to emphasize equities in their portfolio to provide a growth component and inflation hedge. The municipal bond fund would not provide the needed growth component. Leveraged commercial real estate is outside their risk tolerance at this point. Therefore, the best choice would include the S&P 500 Index fund and international stocks.

**Estates – Durable Power of Attorney (easy)**

4. **D**

The only answer that related to “documents” is D.

**Investments – Education Funding (medium)**

5. **A**

Funds for education must meet the appropriate time horizon; therefore, E, which relates to investments that have mature beyond the time horizon, is wrong. D is wrong, because small cap stocks are too risky of an investment for such a short period of time. B does not match the investment vehicle to the time horizon of the investment. The zero-coupon bond allows the Clarkes to match the time horizon of the investments to the duration of the bonds and avoid reinvestment rate risk. Kim is 14; consequently, the Kiddie tax does not apply.

**Investments – Time Horizon (medium)**

6. **B**

Municipal bonds should not be held in a tax-advantaged account. Precious metals are more risky than the Clarkes' risk tolerance would allow. Small cap stocks and international stocks provide growth and diversification and would be appropriate choices for a retirement account with a long-term time horizon.

**Investments – Time Horizon (easy)**

7. **B**

The sabbatical is only 4 years away; therefore, equities would not be appropriate (A, D, E). A 7-year treasury (C) does not match the time horizon of the goal. The only possible choice would be the zero-coupon municipal bond.

**Insurance - Program (easy)**

8. **A**

The objective of the question is to improve the Clarkes' insurance program. Statement #4 clearly improves the program but is remarkably in all answers. Statement #1 is generally a good planning idea. Statement #2 does little to improve the quality of the program. Statement #3 is clearly incorrect, because it would cause the Clarkes to be in a co-insurance situation.

**Retirement - Capital Needs Analysis (medium)**

9. **C**

$$\begin{aligned} N &= 25 \\ i &= 2.0019 \text{ } [[(1.07 \div 1.049) - 1] \times 100] \\ PMT_{AD} &= \$45,000 (\$90,000 - \$45,000) \\ PV_{at \text{ Ret}} &= (\$895,942.85) \end{aligned}$$

**Estates – Probate (medium)**

10. **C**

The question asks for assets included in the probate estate. Generally, assets that transfer by law or contract avoid the probate estate. Pat's SPDA and life insurance policy have named beneficiaries and will, therefore, avoid probate. The proceeds from James' insurance policy, but not his policy, would likely be included in the probate estate. The XYZ stock will certainly be included in the probate estate.

**Tax – S Corporations (easy)**

**11. E**

Owners of S Corporations will receive an annual Schedule K-1. Owners who work for the S Corporation will also receive a Form W-2. Since neither James nor Pat works in the business, they will only receive Schedule K-1.

**SUSAN DAVIS**

**Released as of October 2004**

The alphabetical answer was provided by CFP Board of Standards, Inc. and is used with permission.  
Explanations have been added to the answers, all prepared by BISYS Education Services  
and are not part of CFP Board's materials.

1. C	4. B	7. B	10. C
2. A	5. C	8. A	11. C
3. D	6. C	9. D	12. B

Certified Financial Planner Board of Standards Inc. owns the certification marks CFP®, CERTIFIED FINANCIAL PLANNER™ and CFP (with flame logo)®, which it awards to individuals who successfully complete initial and ongoing certification requirements.

**Fundamentals – Planning (moderate)**

1. **C**

Susan is running a profitable business that shows a net profit of approximately \$120,000 on an annual basis. Her current annual salary is only \$51,600. She should increase her salary (which would provide an additional deduction for the business) and use the additional money to pay down her debt. A is incorrect. Additional borrowing is not necessary. She has a profitable business that she can take additional salary from to generate cash flow. B is incorrect. Although Susan could sell her home to generate cash, this may not be a desirable option. Taking a larger salary from the business would be a more appropriate strategy. D is incorrect. Nothing indicates that Susan is ready to sell 50% of the business. The business book value is \$564,000. Therefore, it would be unwise to sell 50% of the business for only \$100,000.

**Insurance – General (moderate)**

2. **A**

1 is incorrect. Susan does not have a long-term disability policy. She is only covered for 6 months. 2 is correct. The value of the dwelling is \$280,000 (\$330,000 - \$50,000 land value). The 80% coinsurance amount is only \$224,000, and Susan has \$270,000 in coverage. 3 is incorrect. Susan only has \$100,000 of personal liability coverage under the homeowner's policy. She needs an umbrella policy. 4 is correct. Susan has inadequate life insurance coverage. The only insurance coverage she has is the company-provided policy, which is \$103,200 (2 times earnings). 5 is incorrect. Per the divorce agreement, Richard is to provide adequate health insurance coverage on the children.

**Investments – Asset Allocation (moderate)**

3. **D**

A is incorrect. Under this scenario, Susan would invest \$400 into a Roth IRA each month, for a total of \$4,800 for the year. This exceeds the maximum allowable Roth IRA contribution for a calendar year. B is incorrect. This scenario provides for no liquidity of her investments. C is incorrect. Interest rates are low, so the long-term fixed income investment would probably not be appropriate.

**Investments – Risk (difficult)**

4. **B**

Susan's main investment asset is her business. She is not diversified, and has a high business risk exposure. Business risk is a type of unsystematic (diversifiable) risk. A is incorrect. Susan only liquid investment asset is \$2,000 of cash. Her business is illiquid. C is incorrect. Richard is currently receiving 10% interest from the note receivable. If the note were paid off early, and interest rates decreased, Richard would have increased exposure to reinvestment rate risk. D is incorrect. The current mortgage will be paid off in less than five years. If Susan refinances for 30 years at 9.5%, she will be locking herself into a high interest rate for a long-term period.

**Retirement – Plan Types (moderate)**

5. **C**

Susan would like to retain and reward current full time employees of the business while maintaining cash flow flexibility. A profit-sharing plan would allow her to make discretionary contributions, and would allow her to exclude part-time employees working less than 1,000 hours. A is incorrect. A SIMPLE IRA would place the burden of retirement savings predominately on the employees. Susan wants to retain and reward the employees. Also, since many of the part-time employees earn more than \$5,000, they would be eligible to participate. B is incorrect. Although a SEP allows discretionary contributions, part-time employees would most likely be included in the plan. Susan wants to reward full-time employees only. D is incorrect. A target benefit plan is a pension plan that would require an actuary and mandatory contributions.

**Tax – Employee Benefit (difficult)**

6. **C**

1 is incorrect. Susan already offers life insurance coverage equal to two times earnings. Although increasing the insurance coverage would be a good benefit, it is not in the top three benefits given Susan's cost constraints. Susan should purchase a separate policy on her life. 2 and 3 are correct. Both of these adjustments to the medical plan would be cost effective, needed changes. 4 is incorrect. Susan currently provides short-term disability coverage equal to 50% of salary, which is adequate coverage. 5 is correct. Susan currently offers no long-term disability benefits to her employees. She also does not have a long-term disability policy for herself, which is needed.

**Investment – Asset Allocation (moderate)**

7. **B**

This portfolio provides liquidity (money market account), growth (index fund), and income (balanced fund). In addition, this portfolio is consistent with her moderate risk tolerance.

A is incorrect. This entire portfolio consists of cash and cash equivalents. Susan would have a very low rate of return and a high exposure to purchasing power risk. C is incorrect. Susan is a conservative investor and prefers only moderate risks. Investing the majority of the portfolio in an aggressive growth stock fund would be inappropriate for her risk tolerance. D is incorrect. This portfolio is illiquid, and does not have a fixed income component.

**Estates – Planning (difficult)**

8. **A**

Susan has a small amount of life insurance, but needs additional life insurance. The most appropriate strategy for her to take NOW would be to purchase life insurance. B is incorrect. A Section 303 stock redemption is a post-mortem planning technique that could be used to generate liquidity for her estate. The executor could initiate a Section 303 redemption plan after Susan's death. Susan need not take any action with respect to a Section 303 redemption at this time. C is incorrect. Susan does not plan on retiring until age 55. She did not express any desire to sell the business now. D is incorrect. In most situations, a GRIT will not remove assets from the estate. Typically, the grantor retains income from the GRIT for life. This retained life estate will cause gross estate inclusion.

**Retirement – Profit-Sharing Plan (moderate)**

9. **D**

1 is incorrect. A highly compensated person is an individual who owns more than 5% of the company, or earns compensation in excess of \$90,000. Susan is highly compensated because she owns 100% of the company. However, Kate is not highly compensated, because she has no ownership in the company, and her salary is less than \$90,000. 2 is correct. A qualified plan, such as a profit-sharing plan, can restrict participation in the plan to those individuals who have attained age 21 and have completed one year (1,000 hours) of service. Susan's profit-sharing plan has implemented these exact eligibility requirements. 3 is correct. All of the part-time employees would be excluded from the plan because they will not have 1,000 hours, which is the qualified plan threshold for eligibility. 4 is correct. A graded vesting schedule, which is allowed in a profit-sharing plan, would help Susan meet her goal of retaining employees.

**Tax - Alimony (easy)**

10. **C**

1 is correct. To qualify as alimony for income tax purposes, the payments must be made pursuant to a written divorce agreement. 2 is correct. The following are requirements for tax-deductible alimony:

- The agreement must be in writing.
- The payments must be made in cash.
- The former spouses must live apart.
- The agreement cannot specify that the payments are not alimony for income tax purposes.
- The payments must cease upon the death of the recipient.

3 is incorrect. The payments do not constitute excess alimony. Excess alimony occurs when the payments decrease by MORE THAN \$15,000 from the first to second year or second to third year after a divorce. From year 1 to year 2, the payments actually increase. From year 2 to year 3, the payments decrease by exactly (not more than) \$15,000. Years 4 and 5 can be ignored.

**Estates – Trust (moderate)**

11. **C**

A revocable living trust with a third-party trustee would be the most appropriate strategy. The trust would avoid probate, and would provide for her children in the event of her death. A is incorrect. Susan's net worth is \$707,000. She does not have an estate tax problem. A life insurance trust is probably not necessary because the inclusion of the life insurance in her gross estate would not cause an estate tax liability. If she established an ILIT, she would be required to give up control of the life insurance policy. B is incorrect. A GRIT is a trust in which the grantor (Susan) retains income for life. Since Susan will be retaining a life estate, the GRIT will be included in her gross estate upon her death. In addition, Susan may be subject to unfavorable gift tax consequences when establishing the GRIT. D is incorrect. Although a revocable living trust is an appropriate strategy, Richard should not be named the trustee.

**Tax – Personal Residence (easy)**

**12. B**

Susan will have a recognized gain of \$7,000, calculated as follows:

Sales price	\$367,000
Basis (from net worth statement)	<u>(110,000)</u>
Realized (economic) gain	\$257,000
Exclusion for sale of residence	<u>(250,000)</u>
Capital gain	\$ 7,000

The purchase of the new residence is irrelevant.