

CFP® CERTIFICATION EXAMINATION QUESTIONS

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***Questions marked with an asterisk (*) are no longer accurate due to changes in the Federal Tax Code.**

1. Sara filed an extension on April 15. On June 1, she filed her tax return and owed \$400 on a tax liability of \$4,100. Which one of the following will apply?
 - A. Failure to file on a timely basis.
 - B. Failure to pay the total amount due.
 - C. No penalty because of prepayment of over 90% of liability.
 - D. Penalty on \$400.
 - E. Penalty and interest on \$400.

2. Which is the best source for obtaining information about the intent of a very recent change in the tax law?
 - A. RIA Federal Tax Coordinator.
 - B. Congressional Committee Reports.
 - C. Treasury Regulations.
 - D. Tax Court Reports.
 - E. U.S. Master Tax Guide.

3. Jack Jones, age 40, earning \$100,000 a year, wants to establish a defined contribution plan. He employs four people whose combined salaries are \$60,000 and who range in age from 23 to 30. The average employment period is 3½ years. Which vesting schedule is best suited for Jack's plan?
 - A. 3-year cliff vesting.
 - B. 3- to 7-year graded vesting.
 - C. 5-year cliff vesting.
 - D. Immediate vesting.
 - E. 2- to 6-year graded vesting.

**“1994 & 1996 Released Case Scenario and Multiple-Choice Questions”
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4. A client with a large, well-diversified common stock portfolio expresses concern about a possible market decline. However, he/she does not want to incur the cost of selling a portion of their holdings nor the risk of mistiming the market. A possible strategy for him/her would be
- A. Buy an index call option.
 - B. Sell an index call option.
 - C. Buy an index put option.
 - D. Sell an index put option.
 - E. He cannot protect against the decline with these options.
5. The Performance Fund had returns of 19% over the evaluation period and the benchmark portfolio yielded a return of 17% over the same period. Over the evaluation period, the standard deviation of returns from the Fund was 23% and the standard deviation of returns from the benchmark portfolio was 21%. Assuming a risk-free rate of return of 8%, which one of the following is the calculation of the Sharpe index of performance for the fund over the evaluation period?
- A. .3913.
 - B. .4286.
 - C. .4783.
 - D. .5238.
 - E. .5870.
6. Arrange the following financial planning functions into the logical order in which a professional financial planner performs these functions.
- 1. Interview clients, identify preliminary goals.
 - 2. Monitor financial plans.
 - 3. Prepare financial plan.
 - 4. Implement financial strategies, plans, and products.
 - 5. Collect, analyze, and evaluate client data.
- A. 1, 3, 5, 4, 2.
 - B. 5, 1, 3, 2, 4.
 - C. 1, 5, 4, 3, 2.
 - D. 1, 5, 3, 4, 2.
 - E. 1, 4, 5, 3, 2.

- *7. Which one of the following statements is not correct?
- A. Profit-sharing plans fall under the broad category of defined contribution plans.
 - B. Profit-sharing plans are best suited for companies that have unstable earnings.
 - C. A company that adopts a profit-sharing plan is required to make contributions each year.
 - D. The maximum tax-deductible employer contribution to a profit-sharing plan is 15% of covered compensation.
 - E. Neither company profits nor retained earnings are required in order to make contributions.
8. Decedent had made substantial lifetime gifts such that her estate is in the 50% marginal bracket. In the will, she made a bequest of \$100,000 to her adult son with no special arrangements, or allocations, for the payment of the estate taxes. The balance of her estate goes to her husband. How much of this bequest will the son actually receive, assuming no other bequests to him from her estate?
- A. \$50,000 because estate taxes of \$50,000 would be charged against the bequest.
 - B. \$55,000 because the \$10,000 per beneficiary exclusion reduces the taxable amount.
 - C. \$90,000 because the \$10,000 per beneficiary exclusion applies even for adult children.
 - D. \$100,000 because the estate tax will be paid from the residual estate.
 - E. The amount cannot be determined unless one knows whether a QTIP election was made.
9. The standard deviation of the returns of a portfolio of securities will be _____ the weighted average of the standard deviation of returns of the individual component securities.
- A. Equal to.
 - B. Less than.
 - C. Greater than.
 - D. Less than or equal to (depending upon the correlation between securities).
 - E. Less than, equal to, or greater than (depending upon the correlation between securities).

10. Which of the following is not needed to calculate the client's human life value?
- A. Average annual earnings to the age of retirement.
 - B. Estimated annual Social Security benefits after retirement.
 - C. Costs of self-maintenance.
 - D. Number of years from the client's present age to the contemplated age of retirement.
 - E. Selection of an appropriate capitalization rate.
11. According to fundamental analysis, which phrase best defines the intrinsic value of a share of common stock?
- A. The par value of the common stock.
 - B. The book value of the common stock.
 - C. The liquidating value of the firm on a per share basis.
 - D. The stock's current price in an inefficient market.
 - E. The discounted value of all future dividends.
12. Conditions that increase either the frequency or severity of loss are called:
- A. Subrogation.
 - B. Risks.
 - C. Hazards.
 - D. Perils.
 - E. Extenuating circumstances.
13. A client is concerned about the impact that inflation will have on her retirement income. The client currently earns \$40,000 per year. Assuming that inflation averages 5.5% for the first five years, 4% for the next five years and 3½% for the remaining time until retirement, what amount must her first-year retirement income be when she retires thirteen years from now if she wants it to equal the purchasing power of her current earnings?
- A. \$62,550.
 - B. \$68,841.
 - C. \$70,520.
 - D. \$80,231.
 - E. \$83,157.

14. Which one of the following types of investor benefits most from the tax advantage of preferred stocks?
- A. Government.
 - B. Individual.
 - C. Corporate.
 - D. Mutual funds.
 - E. Non-profit institutional.
15. Which one of the following statements is not true for a defined benefit plan?
- A. Favors older participants.
 - B. Arbitrary annual contribution.
 - C. Requires an actuary.
 - D. Maximum retirement benefit of the lesser of \$90,000 (indexed) or 100% of pay per year.
 - E. Requires Pension Benefit Guaranty Corporation (PBGC) premiums.
16. An HO-3 policy (Special form-"All risks of physical loss" except those specifically excluded) with no endorsements excludes which one of the following perils?
- A. Flood.
 - B. Fire.
 - C. Collapse.
 - D. Weight of ice.
 - E. Volcanic eruption.
17. Municipal bonds that are backed by the income from specific projects are known as:
- A. Income bonds.
 - B. Revenue bonds.
 - C. General obligation bonds.
 - D. Debenture bonds.
 - E. Project bonds.

18. A call option with a strike price of 110 is selling for $3\frac{1}{2}$ when the market price of the underlying stock is 108. The intrinsic value of the call is:
- A. 0.
 - B. $1\frac{1}{2}$.
 - C. 2.
 - D. $3\frac{1}{2}$.
 - E. (2).
19. Your client, a wealthy physician in the top marginal tax bracket, is interested in purchasing a franchise in a fast-growing chain with some of his colleagues. After carefully reviewing the proposal, you have determined that apart from a large up-front investment, the business will not need to retain income and the income generated in subsequent years will be paid out to the investors. Furthermore, your client wants to be assured that after investing so large an amount, the business would not be disrupted if one of his partners lost interest or encountered personal financial reversals. What form of business makes the most sense given these circumstances?
- A. Limited Partnership.
 - B. General Partnership.
 - C. C Corporation.
 - D. Professional Corporation.
 - E. S Corporation.
20. In contrast to the Capital Asset Pricing Model, the Arbitrage Pricing Theory (APT):
- A. Is usually a multi-factor model.
 - B. Is primarily using by arbitrageurs to profit from imperfections in security markets.
 - C. Assumes a market portfolio.
 - D. Is a useful technical indicator.

21. The estimated value of a real estate asset in a financial statement prepared by a Certified Financial Planner licensee should be based upon the:
- A. Basis of the asset, after taking into account all straight line and accelerated depreciation.
 - B. Client's estimate of current value.
 - C. Current replacement value of the asset.
 - D. Value that a well-informed buyer is willing to accept from a well-informed seller where neither is compelled to buy or sell.
 - E. Current insured value.
22. With the same dollar investment, which of the following strategies can cause the investor to experience the greatest loss?
- A. Selling a naked put option.
 - B. Selling a naked call option.
 - C. Writing a covered call.
 - D. Buying a call option.
 - E. Buying the underlying security.
23. A client purchased a piece of equipment in 1994 for the client's computer business. Which of the following depreciation methods should be used if the client wishes to maximize tax depreciation?
- A. Modified accelerated cost recovery system (MACRS).
 - B. Accelerated cost recovery system (ACRS).
 - C. Units of production.
 - D. Sum of the year's digits.
 - E. Straight line.

24. Jeffrey and Karen Jones have given cash gifts to their children over the years.

In 1994,

- Mark, age 13, earns \$2,500 in salary.
- Jennifer, age 14, earns \$2,200 in dividends and capital gains.
- Nancy, age 12, earns \$1,900 in dividends and interest.
- Steven, age 10, earns \$900 in dividends and interest.

Whose income is subject to the tax at their parents' marginal rate?

- A. Steven's.
- B. Jennifer's and Nancy's.
- C. Nancy's.
- D. Steven's, Jennifer's, and Nancy's.
- E. Nancy's and Mark's.

*25. A client, age 50 and single, chose early retirement and is receiving from his previous employer's qualified pension plan a monthly pension of \$400. The client elects to work for a small company and will receive \$30,000 in annual compensation. This company does not cover him under a qualified pension plan. The client wants to contribute the maximum deductible amount to an Individual Retirement Account (IRA). The amount of the IRA contribution that he can deduct from his gross income is:

- A. \$0.
- B. \$200.
- C. \$400.
- D. \$1,000.
- E. \$2,000.

26. Your client, ABC Corporation, is considering implementing some form of retirement plan. The client states its objectives for a plan to be, in the order of importance:

1. Rewarding long-term employees.
2. Retention of employees.
3. Providing a level of income at retirement equal to 50% of an employee's earnings.
4. Tax-deductible funding.
5. No risk to employees of benefits available.

The company indicates it is willing to contribute an amount equal to 30% of payroll to such a plan. The company has been in business for 22 years, and during the past decade has consistently been profitable. They furnish you with an employee census. Based upon the stated objectives, you advise ABC Corporation that the most suitable retirement plan for the corporation would be a

- A. Money purchase pension plan.
- B. Non-qualified deferred compensation plan for long-term employees.
- C. Combination of defined benefit and 401(k) plan.
- D. Defined benefit plan.
- E. Profit-sharing plan.

27. When fine arts or antiques are insured under a homeowners policy by an endorsement,

- A. Coverage is usually on a replacement cost basis.
- B. Coverage is usually on an actual cash value basis.
- C. Coverage is usually provided on a valued basis.
- D. The perils are the same as the homeowners policy to which the endorsement is attached.
- E. Coverage limits are the same as the homeowners policy to which the endorsement is attached.

28. Which one of the following statements about life insurance products and their tax attributes is correct?
- A. Modified endowment contracts do not provide a tax-free death benefit if the policyholder dies prior to age 59½.
 - B. Tax-deferred annuities owned by a corporation are eligible for tax-deferred accumulation.
 - C. Permanent life insurance owned by a pension plan is 100% income tax-free to the beneficiary of the plan.
 - D. If a person purchased a life and 20-year term-certain immediate annuity at age 50, there would be no premature distribution penalty.
 - E. Policyholders of single payment deferred annuity contracts purchased prior to 1987 may withdraw funds tax-free from their policy up to basis.
29. If the market risk premium were to increase, the value of common stock (everything else being equal) would:
- A. Not change because this does not affect stock values.
 - B. Increase in order to compensate the investor for increased risk.
 - C. Increase due to higher risk-free rates.
 - D. Decrease in order to compensate the investor for increased risk
 - E. Decrease due to lower risk-free rates.
30. The current annual dividend of ABC Corporation is \$2.00 per share. Five years ago the dividend was \$1.36 per share. The firm expects dividends to grow in the future at the same compound annual rate as they grew during the past five years. The required rate of return on the firm's common stock is 12%. The expected return on the market portfolio is 14%. What is the value of a share of common stock of ABC Corporation using the constant dividend growth model? (Round to the nearest dollar.)
- A. \$11.
 - B. \$17.
 - C. \$25.
 - D. \$36.
 - E. \$54.

31. A client had five credit cards in his wallet when the wallet was stolen. He reported the cards as missing the next morning, but the following transactions had already occurred:

Discover Card	\$350
MasterCard	\$100
VISA	\$425
Sears	\$25
Marshall Fields	\$685

How much is the client's expected liability for the fraudulent transactions on these cards?

- A. \$50.
 - B. \$225.
 - C. \$250.
 - D. \$1,235.
 - E. \$1,585.
- *32. Which of the following statements concerning provisions of tax-sheltered annuities (TSAs) is not true?
- A. A catch-up provision is allowed for all employees with at least fifteen years of service and who made no prior contributions.
 - B. TSAs are available to all employees of a 501(c)(3) organization under provisions of the Internal Revenue Code.
 - C. Contributions to TSAs are made through the use of an exclusion allowance, salary reduction agreement under section 403(b) of the Internal Revenue Code.
 - D. If withdrawals are made from a TSA prior to age 59½, an active employee is subject to a 10% penalty tax.
 - E. A catch-up provision is available to all employees of a 501(c)(3) organization under the provisions of the Internal Revenue Code.

*33. Which statement(s) is/are true for a target benefit plan?

1. It favors older participants.
2. It requires actuarial assumptions.
3. The maximum contribution is 25% of payroll.
4. The maximum individual allocation is the lesser of 25% of pay or the greater of \$30,000 or $\frac{1}{4}$ of the defined benefit dollar limit under Code Section 415.
 - A. 1 and 4 only.
 - B. 2 and 3 only.
 - C. 1, 2, and 4 only.
 - D. 4 only.
 - E. 1 and 3 only.

34. Which of the following statements about assignments is/are true?

1. An absolute assignment is an irrevocable transfer of all ownership rights, which can be accomplished through a sale or gift.
2. A collateral assignment is a temporary transfer of some or all of the ownership rights on condition such rights revert to the assignee.
3. A collateral assignment is a temporary transfer of some or all of the ownership rights whereby such rights revert to the assignor upon satisfaction of agreed-upon conditions.
4. A collateral assignment is a temporary transfer of some or all of the ownership rights on condition such rights revert to the insurance company upon satisfaction of agreed-upon conditions.
 - A. 1, 2, and 3 only.
 - B. 1 and 3 only.
 - C. 2 and 4 only.
 - D. 4 only.
 - E. 1, 2, 3, and 4.

35. In a money purchase pension plan that utilizes plan forfeitures to reduce future employer plan contributions, which of the following components must be factored into the calculation of the maximum annual addition limit?
1. Forfeitures that otherwise would have been reallocated.
 2. Annual earnings on all employer and employee contributions.
 3. Rollover contributions for the year.
 4. Employer and employee contributions to all defined contribution plans.
- A. 1, 2, and 3 only.
 - B. 1 and 3 only.
 - C. 2 and 4 only.
 - D. 4 only.
 - E. 1, 2, 3, and 4.
36. In computing portfolio performance, the Sharpe index uses _____, while the Treynor index uses _____ for the risk measure.
1. Standard deviation.
 2. Variance.
 3. Correlation coefficient.
 4. Coefficient of variation.
 5. Beta.
- A. 5; 1.
 - B. 1; 3.
 - C. 1; 4.
 - D. 1; 5.
 - E. 2; 5.

37. Which of the following is/are characteristics of a municipal bond unit investment trust?
1. Additional securities are not added to the trust.
 2. Shares may be sold at a premium or discount to net asset value.
 3. Shares are normally traded on the open market (exchanges).
 4. The portfolio is self-liquidating.
- A. 1 only.
B. 1 and 4 only.
C. 2 and 3 only.
D. 2 and 4 only.
E. 1, 2, 3, and 4.
38. Which of the following incomes is/are not taxed under Social Security self-employment tax?
1. Rental real estate income.
 2. Small part-time repair shop income.
 3. Shareholder's share of S corporation's income in excess of salary.
 4. Income of an individual working as an independent contractor.
- A. 1, 2, and 3 only.
B. 1 and 3 only.
C. 2 and 4 only.
D. 4 only.
E. 1, 2, 3, and 4.
39. Which of the following is (are) true regarding the ownership of life insurance?
1. A policy can only be issued to the insured.
 2. Generally, assigning a policy requires proof that the insured is still "insurable" meaning still in good health.
 3. Only a person with an insurable interest, generally a relative, a business associate, or lender, can be named as a beneficiary.
 4. The owner can assign (transfer) the policy to whomever he or she chooses, even if the assignee has no insurable interest.
- A. 1, 2, and 3 only.
B. 1 only.
C. 2 and 4 only.
D. 4 only.
E. 1, 2, 3, and 4.

40. Which of the following gifts would constitute a taxable gift?

1. \$25,000 to the donor's adult child.
 2. \$10,000 to a friend.
 3. \$35,000 paid to a friend for medical expenses.
 4. \$15,000 to a college to cover a friend's tuition.
- A. 1, 2, and 3 only.
 - B. 1 and 3 only.
 - C. 2 and 4 only.
 - D. 4 only.
 - E. 1, 2, 3, and 4.

41. Which of the following circumstances would definitely cause the date-of-death value of the gifted property to be included in the donor's gross estate?

1. Donor retains a life estate in the gift property.
 2. Donor retains the power to revoke or amend the gift.
 3. Donor gives more than \$10,000 to one donee in one year.
 4. Donor dies within three years of the date of the gift.
- A. 1, 2, and 3 only.
 - B. 1 and 2 only.
 - C. 2 and 4 only.
 - D. 3 and 4 only.
 - E. 1, 2, 3, and 4.

42. A client's employer has recently implemented a Cash or Deferred Arrangement (CODA) as part of his profit-sharing plan to provide incentive to his employees. The client is advised not to elect to receive the bonuses in cash but to defer receipt of them until retirement for which of the following reasons?

1. The client will not pay current federal income taxes on amounts paid into the CODA.
 2. The client will not pay Social Security (FICA) taxes on amounts paid into the CODA.
 3. The accrued benefits derived from elective contributions are non-forfeitable.
 4. The accrued benefits from non-elective contributions are non-forfeitable.
- A. 1, 2, and 3 only.
 - B. 1 and 3 only.
 - C. 2 and 4 only.
 - D. 3 only.
 - E. 1, 2, 3, and 4.

43. A \$1,000 bond originally issued at par maturing in exactly 10 years bears a coupon rate of 8% compounded annually and a market price of \$1,147.20. The indenture agreement provides that the bond may be called after five years at \$1,050. Which of the following statements is/are true?

1. The yield to maturity is 6%.
 2. The yield to call is 5.45%.
 3. The bond is currently selling at a premium, indicating that market interest rates have fallen since the issue date.
 4. The yield to maturity is less than the yield to call.
- A. 1, 2, and 3 only.
 - B. 1 and 3 only.
 - C. 2 and 3 only.
 - D. 4 only.
 - E. 1, 3, and 4 only.

44. Which of the following statements about industry/regulatory relationships are true?
1. The insurance industry is primarily regulated by each of the 50 states.
 2. The majority of banks are subject to federal regulation by the Federal Reserve System and the Federal Deposit Insurance Corporation.
 3. Pension plan funds are primarily subject to federal regulation.
 4. The organized stock exchanges, such as the New York Stock Exchange, are primarily regulated by the individual states in which they are incorporated.
- A. 1, 2, and 3 only.
B. 1 and 3 only.
C. 2 and 4 only.
D. 2 and 3 only.
E. 1, 2, 3, and 4.
45. A client, age 70, a widower with no close relatives, has crippling arthritis. The client is unable to walk and is confined to a custodial nursing home. Which of the following programs is/are likely to pay benefits towards the cost of the nursing home?
1. Medicare may pay for up to 100 days of care after a 20-day deductible.
 2. Long-term care insurance may pay part if coverage of the facility type is broad enough.
 3. Private medical insurance may pay part if it is a comprehensive major medical policy.
 4. Medicaid may pay if the client has income and assets below state thresholds.
- A. 1, 2, and 3 only.
B. 1 and 3 only.
C. 2 and 4 only.
D. 4 only.
E. 1, 2, 3, and 4.

46. Which of the following are common actuarial assumptions used in determining the plan contributions needed to fund the benefits of a defined benefit plan?

1. Investment performance.
2. Employee turnover rate.
3. Salary scale.
4. Ratio of single to married participants.
 - A. 1, 2, and 3 only.
 - B. 1 and 3 only.
 - C. 2 and 4 only.
 - D. 4 only.
 - E. 1, 2, 3, and 4.

47. Which statement(s) is/are true regarding qualified profit-sharing plans?

1. A company must show a profit in order to make a contribution for a given year.
2. A profit-sharing plan is a type of retirement plan and thus is subject to minimum funding standards.
3. Forfeitures in profit-sharing plans must be credited against future years' contributions.
4. Profit-sharing plans should make contributions that are "substantial and recurring" according to the IRS.
 - A. 1, 2, and 3 only.
 - B. 1 and 3 only.
 - C. 1, 2, and 4 only.
 - D. 1, 2, 3, and 4.
 - E. 4 only.

48. Which of the following are non-diversifiable risks?

1. Business risk.
 2. Management risk.
 3. Company or industry risk.
 4. Market risk.
 5. Interest rate risk.
 6. Purchasing power risk.
- A. 4, 5, and 6 only.
 - B. 1, 2, and 3 only.
 - C. 5, 6, and 2 only.
 - D. 1, 3, and 4 only.
 - E. 1, 4, and 6 only.

49. American depository receipts (ADRs) are used to:

1. Finance foreign exports.
 2. Eliminate currency risk.
 3. Sell U.S. securities in overseas markets.
 4. Trade foreign securities in U.S. markets.
- A. 1 and 3 only.
 - B. 1 and 4 only.
 - C. 2 and 4 only.
 - D. 4 only.
 - E. 1, 2, and 4 only.

50. A minority non-employee shareholder in an S corporation:

1. Receives compensation when the corporation declares a dividend.
 2. Votes for the Board of Directors at the annual shareholders' meeting.
 3. Receives a K-1 annually in order to prepare a personal income tax return.
 4. Reports on a personal income tax return a pro-rata share of corporate profit or loss.
- A. 1, 2, and 3 only.
 - B. 1 and 3 only.
 - C. 2 and 4 only.
 - D. 4 only.
 - E. 1, 2, 3, and 4.

51. A young couple would like to purchase a new home using one of the following mortgages:

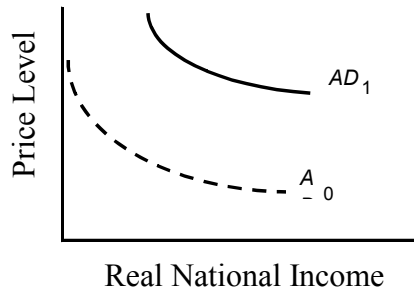
#1: 10.5% interest with 5 discount points to be paid at time of closing.

#2: 11.5% interest with 2 discount points to be paid at time of closing.

Assuming the couple could qualify for both mortgages, which of the following aspects should be considered in deciding between these two mortgages?

1. Gross income.
 2. Estimated length of ownership.
 3. Real estate tax liability.
 4. Cash currently available.
- A. 1 and 2 only.
 - B. 2 only.
 - C. 2 and 4 only.
 - D. 4 only.
 - E. 1, 2, 3, and 4.

52. Movement through the phases of the business cycle is initiated by shifts in aggregate demand that create fluctuations in Gross Domestic Product (GDP). Which combination of the following statements would be the most significant contributor to the upward shift in aggregate demand shown in the graph?



1. Increase in demand for capital goods.
 2. Increase in interest rates.
 3. Increase in disposable income.
 4. Increase in savings.
- A. 1 and 3 only.
B. 1, 2, and 3 only.
C. 1, 3, and 4 only.
D. 2 and 4 only.
E. 3 and 4 only.

53. Jack and Jill Jones, age 65, have decided that, in order to best pay their \$3,000,000 federal estate tax bill, they will purchase a second-to-die life insurance policy. In order to keep the proceeds out of their estate, they were advised to create an irrevocable life insurance trust. Jack and Jill applied for the insurance and the policy was issued to them. An irrevocable trust was drafted. The policy was transferred into the irrevocable trust, and 90 days later both Jack and Jill were killed in a plane crash. The Internal Revenue Service wants to include the insurance in the estate for tax purposes. Which statement(s) is/are correct?

1. The insurance will be included in the estate because the trust was drafted after the insurance was approved.
2. The insurance will be included in the estate because the premiums were a gift from the insured.
3. The insurance will be included in the estate because the insureds transferred the policy within three years of death.
4. The Internal Revenue Service is wrong--the insurance will not be included in the estate.
 - A. 1, 2, and 3 only.
 - B. 1 only.
 - C. 2 and 3 only.
 - D. 3 only.
 - E. 4 only.

54. Which combination of the following statements about bond swaps is true?

1. A substitution swap is designed to take advantage of a perceived yield differential between bonds that are similar with respect to coupons, ratings, maturities, and industry.
2. Rate anticipation swaps are based on forecasts of general interest rate changes.
3. The yield pickup swap is designed to change the cash flow of the portfolio by exchanging similar bonds that have different coupon rates.
4. The tax swap is made in order to substitute capital gains for current yield.
 - A. 1, 2, and 3 only.
 - B. 1 and 3 only.
 - C. 2 and 4 only.
 - D. 4 only.
 - E. 1, 2, 3, and 4.

55. Six months ago, a client purchased a new bedroom suite for \$6,500. For purposes of preparing accurate financial statements, this purchase would appear as a(an)
1. Use asset on the client's net worth statement.
 2. Investment asset on the client's net worth statement.
 3. Variable outflow on the client's historic cash flow statement.
 4. Fixed outflow on the client's cash flow statement.
- A. 1, 2, and 3 only.
 - B. 1 and 3 only.
 - C. 2 and 4 only.
 - D. 4 only.
 - E. 1, 2, 3, and 4.
56. A client purchased a mutual fund with a \$10,000 lump-sum amount four years ago. During the four years, \$4,000 of dividends was reinvested. Today the shares are valued at \$20,000 (including any shares purchased with dividends). If the client sells shares equal to \$13,000, which statement(s) is/are correct?
1. The taxable gain can be based on an average cost per share.
 2. The client can choose which shares to sell, thereby controlling the taxable gain.
 3. To minimize the taxable gain today, the client would sell shares with the higher cost basis.
 4. The client will not have a gain as long as he/she sells less than what he/she invested.
- A. 1, 2, and 3 only.
 - B. 1 and 3 only.
 - C. 2 and 4 only.
 - D. 4 only.
 - E. 1, 2, 3, and 4.

57. A contract for variable life insurance may be characterized as a/an
1. Unilateral contract.
 2. Aleatory contract.
 3. Conditional contract.
 4. Personal contract of adhesion.
 - A. 1, 2, and 3 only.
 - B. 1 and 3 only.
 - C. 2 and 4 only.
 - D. 3 and 4 only.
 - E. 1, 2, 3, and 4.
58. Which combination of the following statements concerning federal law is correct?
1. The Securities Act of 1933 provides for protection from misrepresentation, deceit, and other fraud in the sale of new securities.
 2. The Securities Investor Protection Act of 1970 is designed to protect individual investors from losses as a result of brokerage house failures.
 3. The Investment Advisers Act of 1940 requires that persons or firms advising others about securities investment must register with the Securities and Exchange Commission.
 4. The Investment Advisers Act of 1940 assures the investor safety of investment in companies engaged primarily in investing, reinvesting, and trading in securities.
 - A. 1, 2, and 3 only.
 - B. 1 and 3 only.
 - C. 2 and 4 only.
 - D. 2 and 3 only.
 - E. 1, 2, 3, and 4.

59. Modern "asset allocation" is based upon the model developed by Harry Markowitz. Which of the following statements is/are correctly identified with this model?

1. The risk, return and covariance of assets are important input variables in creating portfolios.
 2. Negatively correlated assets are necessary to reduce the risk of portfolios.
 3. In creating a portfolio, diversifying across asset types (e.g., stocks and bonds) is less effective than diversifying within an asset type.
 4. The efficient frontier is relatively insensitive to the input variable.
- A. 1 and 2 only.
 - B. 1, 2, and 3 only.
 - C. 1 only.
 - D. 2 and 4 only.
 - E. 1, 2, and 4 only.

CFP® CERTIFICATION EXAMINATION QUESTIONS

Released as of December 1996

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Instructions: Choose the one best answer to each of the following questions.

1. Jane has the following income and losses for the current year:

- (\$1,500) loss from a 30% interest in Laminate Partnership in which she does not materially participate.
- (\$500) loss from a 0.2% limited partnership interest in Venture, a limited partnership.
- (\$2,400) loss from a 12% interest in an S corporation in which she manages one of the departments.
- \$32,000 salary as manager with an S corporation.
- \$600 of dividend income from Higher Mutual Fund.

What is Jane's adjusted gross income?

- A. \$28,200.
- B. \$30,000.
- C. \$30,200.
- D. \$32,000.
- E. \$32,600.

*2. Mary, age 45, sold her home for \$176,000 in September of 1994 after living there since 1986. The selling expenses were \$10,000 and her adjusted basis in that home was \$132,000. She rented an apartment until August of 1996 when she bought and moved into a new personal residence. She paid \$155,000 for the new home. What is the maximum gain that Mary must report in connection with sale of her principal residence?

- A. \$0.
- B. \$11,000.
- C. \$21,000.
- D. \$34,000.
- E. \$44,000.

**“1994 & 1996 Released Case Scenario and Multiple-Choice Questions”
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3. Your client has a salary of \$80,000, dividends of \$20,000, and limited partnership income of \$15,000. This year, she invested in an equipment-leasing partnership. Her initial investment included \$50,000 cash and a non-recourse note for \$60,000. What is the maximum tax deduction your client may take on this investment this year?
- A. \$15,000.
 - B. \$35,000.
 - C. \$45,000.
 - D. \$50,000.
4. Municipal bonds are frequently insured. One of the insurers is the:
- A. Federal Insurance Guarantee Corporation.
 - B. Resolution Trust Corporation.
 - C. Associated Municipal Bond Corporation.
 - D. Municipal Insurance Group.
 - E. Municipal Bond Insurance Association.
5. Temporary insurance coverage, contingent on an applicant's ability to present evidence of insurability, can be provided by:
- A. Evidence of consideration.
 - B. Conditional receipt.
 - C. Delivery of contract.
 - D. Initial premium payment.
6. Which of the following is a deduction from the gross estate used to calculate the adjusted gross estate?
- A. Costs associated with maintaining estate assets.
 - B. Non-taxable gifts made within three years of death.
 - C. Federal estate tax marital deduction.
 - D. Property inherited from others.

7. Which of the following retirement plans would permit an employee making \$100,000 a year to still make a fully deductible \$2,000 contribution to an IRA?
- A. 401(k).
 - B. 403(b).
 - C. SEP.
 - D. 457.
 - E. Defined benefit plan.
8. Which one of the following products is designed to provide both growth and income?
- A. Fixed premium annuity.
 - B. Non-participating mortgage real estate investment trust (REIT).
 - C. Aggressive growth mutual fund.
 - D. Convertible bond.
9. Jennifer is optimistic about the long-term growth of her Widget stock. However, the stock, currently priced at \$58, has made a sharp advance in the last week and she wants to lock in a minimum price in case the shares drop. What might Jennifer do?
- A. Buy \$55 call options.
 - B. Sell \$55 call options.
 - C. Buy \$55 put options.
 - D. Sell \$55 put options.
10. The Moores recently found out that they can reduce their mortgage interest rate from 12% to 8%. The value of homes in their neighborhood has been increasing at the rate of 7.5% annually. If the Moores were to refinance their house with \$2,000 in closing costs in addition to the mortgage balance (\$120,056) over a period of time to coincide with their chosen retirement age in 22 years, what would the monthly payment be for principal and interest (closing costs are going to be added to the mortgage)?
- A. \$853.43.
 - B. \$895.60.
 - C. \$945.34.
 - D. \$967.86.
 - E. \$983.99.

11. Company ABC is currently trading at \$35 and pays a dividend of \$2.30. Analysts project a dividend growth rate of 4%. Your client Tom requires a rate of 9% to meet his stated goal. Tom wants to know if he should purchase stock in Company ABC.

- A. Yes, the stock is undervalued.
- B. No, the stock is overvalued.
- C. No, the required rate is higher than the projected growth rate.
- D. Yes, the required rate is higher than the expected rate.
- E. No, the required rate is lower than the expected rate.

12. Your client will only invest in securities backed by the full faith and credit of the US government. Which of the following would you consider for his portfolio?

- A. Federal Home Loan Mortgage Association Debentures ("Freddie Macs").
- B. Federal National Mortgage Association Debentures ("Fannie Maes").
- C. Government National Mortgage Association Certificates ("Ginnie Maes").
- D. Student Loan Marketing Association Notes ("Sallie Maes").
- E. Tennessee Valley Authority (TVA) Securities.

13. If the client needs to accumulate wealth but is risk-averse, which of the following is the most crucial action the planner needs to take to have the client achieve the goal of wealth accumulation? Advise investing the client's current assets

- A. In the products which will bring the highest return to the client regardless of risk.
- B. In products that produce high income for the client because fixed income products are generally safe.
- C. In diversified mutual funds because of the protection which diversity provides.
- D. After determining the client's risk tolerance.
- E. In 100% cash equivalents in the portfolio because most software programs recommend this safe approach.

- *14. Your client John Smith, a sole-employee owner of a corporation, has a maximum contributory profit-sharing plan. John has asked you to suggest a method for increasing his tax-deductible retirement plan contributions. The best option is that he:
- A. Contribute to an IRA in addition to his profit-sharing plan.
 - B. Establish a 401(k) plan in addition to his profit-sharing plan.
 - C. Increase his salary.
 - D. Establish a money purchase pension plan in addition to his profit-sharing plan.
 - E. Establish an SEP IRA and terminate the profit-sharing plan.

15. Your client is contemplating the exchange of two parcels of investment land for two similar parcels. Given the following details of the proposed transactions, compute the amount of recognized gain and loss (if any) on both parcels if your client does the exchanges.

Parcel A: ten acres of land acquired 15 years ago with a current basis of \$50,000. In exchange your client will receive eight acres of land (FMV \$80,000) and \$20,000 of cash.

Parcel B: twenty acres of land acquired two years ago with a current basis of \$100,000. In exchange your client will receive twelve acres of land (FMV \$75,000) and \$10,000 of cash.

	Parcel A	Parcel B
	<u>Recognized Gain</u>	<u>Recognized Loss</u>
A.	\$20,000	\$0
B.	\$20,000	\$10,000
C.	\$50,000	\$10,000
D.	\$20,000	\$15,000
E.	\$50,000	\$15,000

16. Which one of the following goals can be accomplished using a "pour over" provision in a will?
- A. Transfer of assets from an estate into a trust created prior to the "pour over" provision.
 - B. Minimization of estate taxes resulting from assets owned prior to the existence of the "pour over" provision.
 - C. Transfer of assets from an estate to the estate of another person who died within the past three years.
 - D. Reduction of probate expenses during administration.

17. Typically when group long-term disability income insurance premiums are paid by a C corporation, all disability benefit amounts received by an employee are:
- A. Not includible in the income of the employee for federal tax purposes without regard to any other sources of income.
 - B. Includible in the income of the employee for federal tax purposes without regard to any other sources of income.
 - C. Not includible in the income of the employee for federal tax purposes if any portion of the benefit is reduced/offset by other income.
 - D. Includible in the income of the employee for federal tax purposes if any portion of the benefit is reduced/offset by other income.
 - E. Includible in the income of the employee for federal tax purposes unless he or she is over age 65.
18. The investment portfolio for a defined-benefit retirement plan has declined in value during a year in which most financial market investments have incurred losses. Which one of the following entities would be impacted most by this decline in portfolio value?
- A. Individual participants in the plan.
 - B. Company sponsoring the plan.
 - C. Investment banker handling the plan.
 - D. Plan underwriters.
19. A client was divorced in 1994. The client's ex-spouse has custody of their 10 year-old daughter. During 1995, your client made alimony payments of \$12,000 paid to contractors and maintenance workers for upkeep of the ex-spouse's house. In addition, the client paid child support payments of \$6,000 to the ex-spouse. Your client's adjusted gross income before any deductions for the above-listed expenses was \$75,000. What is the appropriate amount of the deduction on your client's 1995 federal income tax return?
- A. \$0.
 - B. \$6,000.
 - C. \$12,000.
 - D. \$18,000.

20. Mr. and Mrs. Smith come to you for advice on the financing of their son's college education at their state university. Even though their annual family income exceeds \$70,000, they have not saved enough for his college expenses. You advise that their best opportunity to acquire education funds would be through

- A. Pell Grants.
- B. Subsidized Stafford Student Loans.
- C. Supplemental education opportunity grants.
- D. Parent loans for undergraduate students (PLUS).

21. A testator-selected survival clause inserted in a will is better than reliance on a state's Uniform Simultaneous Death Act (USDA) because

- A. Most states have not enacted a USDA.
- B. The USDA always creates the presumption that the husband died first.
- C. The USDA presumption will not apply if the order of deaths can be determined, even if one person outlived the other by a microsecond.
- D. The USDA presumption, when applicable, almost always results in higher estate taxes.
- E. The USDA presumption is applicable only where the two people that die are married.

*22. Mr. and Mrs. Jones have a combined estate of \$2,000,000. They have \$1,000,000 in stocks and bonds, \$500,000 in bank accounts and money markets and a \$500,000 residence. All of the property is held in joint tenancy with right of survivorship. Their wills leave all of their estate to the surviving spouse, if no surviving spouse, then to their three adult children, per stirpes. The combined administration expenses and debts are estimated to be \$150,000 at the second death. Their state's death tax equals the federal state death tax credit. How much death-tax savings would result if they establish a new estate plan utilizing a credit shelter trust and a QTIP trust assuming all taxes are postponed until the second death and all values stay the same?

- A. \$192,800.
- B. \$265,000.
- C. \$268,000.
- D. \$280,300.
- E. \$431,700.

23. Which of the following statements is false?

- A. Federal law does not require those selling a group annuity contract with multiple investment choices including equity funds to have a securities license or to provide a prospectus if it is sold to a qualified plan.
- B. If you are licensed to sell life insurance and fixed annuities in your own state, you can sell those same products in all states except New York without additional licensing.
- C. In almost all states it is illegal to rebate commissions.
- D. The minimum licensing requirements in most states for selling variable annuity contracts are proper state life and annuity licenses and a Series 6 securities license.
- E. Currently, there is no federal legislation covering licensing or regulation of capital requirements for insurance companies.

24. Rank from lowest to the highest the risk of annual premiums increasing on the following life insurance policies on a male age 35. Premiums are projected to vanish at 65. After a careful review of each company's Insurance Questionnaire, it is concluded that all companies use realistic expense, mortality and lapse assumptions. All companies have demonstrated good historical results for policyholders. Assume further that a 30-year Treasury bond yields 7% and that all companies will have similar future investment returns.

- 1. Variable universal life insurance (illustrated to endow at age 100, run at 8% gross and allocated 100% to common stock sub-account).
 - 2. Interest sensitive whole life insurance (illustrated at current rate of 8.5% and funded at full target premium).
 - 3. Universal life insurance (illustrated at current projected new money rate of 6.75%).
 - 4. Whole life insurance (25% base policy, with 5.5% guarantee; 75% term rider -- ledger illustrated at company's portfolio rate of 9.5% -- company's net investment yield is 9.66% for this current year).
- A. 3, 1, 2, 4.
 - B. 2, 4, 1, 3.
 - C. 2, 4, 3, 1.
 - D. 2, 1, 3, 4.
 - E. 3, 2, 4, 1.

25. A pre-marital agreement should not be considered by individuals contemplating marriage in which one of the following situations?
- A. When one or both parties are unwilling to make a full disclosure of all their income and assets to the other party.
 - B. When each party has significant wealth and wishes to protect his/her financial independence.
 - C. When there is a significant difference in the wealth of each party.
 - D. When one or both parties have ongoing obligations, rights and/or children from a previous marriage.
 - E. When one party is considering making a substantial gift to the other in consideration of the marriage.
26. Which of the following would result in the largest increase in the price of a diversified common stock mutual fund?
- A. Unexpected inflation.
 - B. Expected dividend increases.
 - C. Unexpected corporate earnings growth.
 - D. Expected increase in the prime interest rate.
27. In analyzing the position of a portfolio in terms of risk/return on the capital market line (CML), superior performance exists if the fund's position is _____ the CML, inferior performance exists if the fund's position is _____ the CML, and equilibrium position exists if it is _____ the CML.
- A. Above; on; below.
 - B. Above; below; on.
 - C. Below; on; above.
 - D. Below; above; on.
 - E. On; above; below.

28. Which one of the following best describes a debenture?
- A. A long-term corporate promissory note.
 - B. An investment in the debt of another corporate party.
 - C. A long-term corporate debt obligation with a claim against securities rather than against physical assets.
 - D. A corporate debt obligation that allows the holder to repurchase the security at specified dates before maturity.
 - E. Unsecured corporate debt.
29. If qualified plan eligibility begins after an employee reaches age 21 and completes two years of service, which of the following vesting schedules would be required?
- A. 3-year cliff.
 - B. 3-7 year graded.
 - C. 4-40 vesting.
 - D. Full and immediate.
 - E. 2-6 year graded.
30. A correct statement regarding the use of a Grantor Retained Annuity Trust (GRAT) as an estate-planning technique is that such a strategy:
- A. Is appropriate only if the remainder beneficiary is the grantor's spouse.
 - B. Saves estate taxes only if the grantor lives beyond the trust term.
 - C. Guarantees that the trust property will receive a stepped-up basis at the grantor's death.
 - D. Is generally inappropriate if the trust corpus consists of income-producing assets.
31. An employee retired under a defined-benefit retirement plan at the end of 1995. Her highest consecutive annual salaries were \$90,000, \$100,000, and \$110,000, respectively, in 1993, 1994, and 1995. What is the maximum annual benefit that could have been paid to her under the plan?
- A. \$30,000.
 - B. \$90,000.
 - C. \$100,000.
 - D. \$118,800.
 - E. There is no limit on benefits under a defined-benefit plan.

32. Your client owns a whole-life insurance policy with a death benefit of \$200,000 on the life of his spouse. The policy has a cash value of \$13,500 of which the dividends are used to purchase additional paid-up life insurance. Their son is the named beneficiary. If the spouse were to die today, which of the following is true?
- A. The client continues to own the policy for the benefit of the son.
 - B. A taxable gift of the life insurance proceeds has been made from the client to the son.
 - C. The client receives an amount equal to the cash value, and the son receives the remainder of the life insurance proceeds tax-free.
 - D. The son must be at least 14 years old in order to collect the proceeds.
 - E. The client receives the proceeds of the life insurance policy but must hold them in a life insurance trust for the benefit of the son.

Instructions: Read each of the options, then select the combination of options that correctly responds to the question.

33. Of the following situations, which is/are more likely to result in the Internal Revenue Service challenging the reasonableness of compensation paid to a shareholder-employee?
1. Compensation that is computed according to a contingent compensation agreement.
 2. Compensation paid by a company that has a history of not paying dividends.
 3. Compensation, which is paid under a cost-of-living clause in an employment agreement.
 4. Compensation paid by a company in a personal service business.
 5. Compensation paid by a company in a capital-intensive business.
- A. 4 only.
B. 1 and 3.
C. 2 and 4.
D. 2 and 5.
E. 1, 3, and 5.
- *34. Your 59 year-old client has been offered early retirement with an option of a two-year consulting contract. He has been a participant for the past 20 years in both the company defined benefit plan and defined contribution plan. The account balance is \$120,000 in the profit-sharing plan, present value of accrued benefit of the defined benefit plan is \$240,000; both provide for a lump-sum distribution. Which of the following options is/are available under the lump-sum distribution rules?
1. Elect ten-year averaging on both plans.
 2. Roll over the taxable portions of both plans to an IRA.
 3. Elect long-term capital gains treatment and ten-year averaging on both plans.
 4. Elect five-year averaging on both plans.
- A. 1, 2, and 3.
B. 1 and 2.
C. 2 and 4.
D. 4 only.
E. 1, 2, 3, and 4.

*35. Which combination of the following statements is correct about a Section 401(k) CODA (cash or deferred plan)?

1. The employee must have a choice of receiving an employer contribution in cash or having it deferred under the plan.
 2. Section 401(k) states that during the first year of participation in a qualified CODA, the vested benefits derived from employee contributions can be forfeited if the employee is terminated.
 3. As a condition of participation, the plan requires that an employee complete at least three years of service with the employer.
 4. In addition to an indexed limitation for any taxable year on exclusions for elective deferrals, the law caps the amount of pay that can be taken into account for most qualified plans at \$150,000.
- A. 1, 2, and 3.
 - B. 2 and 4.
 - C. 1 and 4.
 - D. 1, 2, 3, and 4.
 - E. 2, 3, and 4.

*36. As the fiduciary for a company defined benefit plan, you were recently approached by the employer, a sole proprietor. She requested a loan from the assets of the pension plan to purchase equipment needed by the company. You respond that the loan request is

1. Acceptable if made to the employer as a participant in the plan.
 2. Acceptable if it bears a reasonable rate of interest in respect to current market rates.
 3. Acceptable since the money will be invested in the company and is not intended to directly benefit the employer.
 4. Not acceptable, since the employer is considered a party-in-interest.
- A. 2 only.
 - B. 4 only.
 - C. 2 and 3.
 - D. 1, 2, and 3.

37. Insofar as employment and production are concerned, which two of the following industries are typically more affected by recession?

1. Capital goods.
2. Consumer durable goods.
3. Consumer non-durable goods.
4. Services.
 - A. 1 and 3.
 - B. 1 and 2.
 - C. 2 and 3.
 - D. 3 and 4.
 - E. 2 and 4.

38. While deciding whether to equalize the estates at the death of the first spouse, or to defer estate taxes until the death of the surviving spouse, it is important to consider

1. The age and health of the surviving spouse.
2. Whether the combined estates exceed two unified credit equivalents.
3. Whether the surviving spouse wants to make gifts to the children.
4. Whether the estates have substantial appreciation potential.
 - A. 1, 2, and 3.
 - B. 3 only.
 - C. 2 and 4.
 - D. 1, 2, and 4.
 - E. 1, 2, 3, and 4.

39. In May, 1993, Joe Edd bought a tax-exempt original issue discount (OID) bond. Which of the following statements apply?
1. The bond basis increases at a set rate each year.
 2. The difference between the maturity value and the original issue discount price is known as the OID.
 3. The bond's earnings are treated as exempt interest income.
 4. The bond was issued at a discount to its par value.
- A. 2 and 3.
 - B. 1 and 4.
 - C. 1, 2, and 4.
 - D. 3 only.
 - E. 1, 2, 3, and 4.
40. A client has a cash need at the end of seven years. Which of the following investments might initially immunize the portfolio?
1. A 9-year maturity coupon bond.
 2. A 7-year maturity coupon Treasury note.
 3. A series of Treasury bills.
- A. 1, 2, and 3.
 - B. 1 only.
 - C. 2 and 3.
 - D. 2 only.
 - E. 1 and 2.

41. Your client, the chief financial officer of a new company, wishes to install a retirement plan in the company in which the pension benefits to employees are guaranteed by the Pension Benefit Guaranty Corporation (PBGC). Identify the plan(s) below that must meet this requirement.
1. Profit-sharing plan.
 2. Money purchase plan.
 3. Target benefit plan.
 4. Defined benefit plan.
- A. 1 and 2.
 - B. 2 and 3.
 - C. 1 only.
 - D. 3 and 4.
 - E. 4 only.
42. Which combination of the following statements about investment risk is correct?
1. Beta is a measure of systematic, non-diversifiable risk.
 2. Rational investors will form portfolios and eliminate systematic risk.
 3. Rational investors will form portfolios and eliminate unsystematic risk.
 4. Systematic risk is the relevant risk for a well-diversified portfolio.
 5. Beta captures all the risk inherent in an individual security.
- A. 1, 2, and 5.
 - B. 1, 3, and 4.
 - C. 2 and 5.
 - D. 2, 3, and 4.
 - E. 2 and 5.

43. Jack and Jill filed for divorce after 31 years of marriage. The court-ordered division of property included an award to Jill of one-half interest in Jack's vested defined benefit pension. This qualified domestic relations order (QDRO) could include which of the following options for Jill?
1. When Jack retires, Jill could be treated as his spouse for purposes of any joint and survivor annuity payments.
 2. If Jack died before retirement, Jill could be treated as the surviving spouse for purposes of any death benefits accrued under the defined benefit plan.
 3. Jill can force Jack to receive a lump-sum distribution from the plan and roll her one-half share over to an IRA.
 4. If Jill dies before Jack retires, the QDRO could also require Jack to substitute their physically impaired, dependent child to receive Jill's benefit.
- A. 1, 2, and 3.
 - B. 1 and 3.
 - C. 2 and 4.
 - D. 3 and 4.
 - E. 1, 2, and 4.
44. Which of the following statements concerning supply and/or demand is/are true?
1. If demand increases and supply simultaneously decreases, equilibrium price will rise.
 2. There is an inverse relationship between price and quantity demanded.
 3. If demand decreases and supply simultaneously increases, equilibrium price will fall.
 4. If demand decreases and supply remains constant, equilibrium price will rise.
- A. 1, 2, and 3.
 - B. 1 and 3.
 - C. 2 and 4.
 - D. 4 only.
 - E. 1, 2, 3, and 4.

45. Harold used his own funds to create an irrevocable life insurance trust created five years before his death. The trustee purchased a single premium life insurance policy at that time. Harold and Ruth were married. Harold was the insured. The insurance was paid to the trustee after Harold died. Ruth received trust income for life. Ruth recently died and the trust terminated and went to their children by right of representation. Assuming a properly drafted irrevocable trust document, which statement(s) is/are true?

1. The proceeds will not be taxed as part of Harold's estate.
 2. The trust will not be subject to probate.
 3. The proceeds will not be taxed as part of Ruth's estate.
 4. The trust will not direct the trustee to pay estate taxes.
- A. 1, 2, and 3.
 - B. 1 and 3.
 - C. 2 and 4.
 - D. 4 only.
 - E. 1, 2, 3, and 4.

46. Which combination of the following statements about the marital deduction is true?

1. The marital deduction has the effect of treating the husband and wife as one economic unit for gift and estate taxes.
 2. Property that qualifies for the marital deduction is excluded from the surviving spouse's estate.
 3. Qualifying all of the decedent's property for the marital deduction may result in more estate tax being paid.
 4. A qualified domestic trust is used to provide for the spouse when there has been a second marriage.
- A. 1, 2, and 3.
 - B. 2 and 4.
 - C. 1, 3, and 4.
 - D. 1 and 3.
 - E. 2 only.

47. Which of the following is/are true about a rabbi trust?
1. The trust is revocable and the employer can always rescind it.
 2. The employer may fund the trust from the general assets of the company.
 3. Employer contributions to the trust are exempt from payroll taxes.
 4. The trust's assets may be used for purposes other than discharging the obligation to the employee.
- A. 1, 2, and 3.
 - B. 1 and 4.
 - C. 2, 3, and 4.
 - D. 2 only.
 - E. 4 only.
48. According to ERISA, which of the following is/are required to be distributed automatically to defined benefit plan participants or beneficiaries?
1. Annual accrued benefit as of the end of the previous year.
 2. The plan's summary annual report.
 3. A detailed descriptive list of investments in the plan's fund.
 4. Terminating employee's benefit statement.
- A. 1, 2, and 3.
 - B. 1 and 2.
 - C. 2 and 4.
 - D. 4 only.
 - E. 1, 2, 3, and 4.

49. Which of the following gifts made two years before the donor's death will be included in the gross estate at full date-of-death value?

1. A gift of \$50,000 cash that is split equally between a son and daughter-in-law.
 2. A gift in which the donor retains an income interest for life.
 3. Donor's residence transferred into joint tenancy with donor's daughter
 4. Stock worth \$30,000 given to a friend.
 5. Life insurance policy (cash value \$5,000) transferred by the deceased to an irrevocable trust.
- A. 1, 2, and 3.
 - B. 1 and 4.
 - C. 1, 2, and 5.
 - D. 3, 4, and 5.
 - E. 2, 3, and 5.

50. Identify the statement(s) below that correctly characterize(s) property interests held by the decedent that, at death, pass by operation of law.

1. If the property passes according to the operation of law, the property avoids probate.
 2. If the property passes according to the operation of law, it will not be included in the decedent's gross estate.
 3. Property that passes by operation of law cannot qualify for the marital deduction.
 4. The titling on the instrument determines who shall receive the property.
- A. 1 only.
 - B. 2, 3, and 4.
 - C. 1 and 4.
 - D. 1, 3, and 4.
 - E. 2 and 3.

51. Which combination of the following statements is true regarding the investment strategy known as “dollar-cost averaging”?
1. Invests the same dollar amount each month over a period of time.
 2. Purchases the same number of shares each month over a period of time.
 3. Lowers average cost per share over a period of time (assuming share price fluctuations).
 4. Invests the same dollar amount each month to protect the investment from loss of capital.
- A. 1 and 2.
 - B. 1 and 3.
 - C. 2 and 3.
 - D. 2 and 4.
 - E. 1, 2, 3, and 4.
52. Identify the statement(s) below that correctly identify(ies) gift giving likely to result in favorable tax consequences.
1. An advantage of giving property with a current value that is less than its basis (“loss property”) is that when the recipient sells the property the loss is available to offset any gains.
 2. Elderly taxpayers should give highly appreciated, low basis property in preference to cash.
 3. Making net gifts is a technique for clients who do not have very much in liquid assets and who want to make taxable gifts.
 4. The donee can depreciate depreciable property based on its value for gift tax purposes.
- A. 1, 2, and 3.
 - B. 2, 3, and 4.
 - C. 1 and 4.
 - D. 1, 3, and 4.
 - E. 3 only.

53. Which of the following is/are true concerning non-qualified deferred-compensation plans?
1. They can provide for deferral of taxation until the benefit is received.
 2. They can provide for fully secured benefit promises.
 3. They can give an employer an immediate tax deduction and an employee a deferral of tax.
- A. 1 only.
 - B. 2 only.
 - C. 3 only.
 - D. 1 and 3.
 - E. 2 and 3.
54. In group life insurance plans provided by employers, which of the following statements about the conversion privilege is/are true?
1. The policy may be converted from a term policy to an individual permanent life policy.
 2. The policy may be converted from a permanent product to a term product.
 3. The policy may be converted if the insured provides evidence of insurability.
 4. At conversion, the billing is switched to the insured.
- A. 1 and 4.
 - B. 1, 2, and 3.
 - C. 1, 2, 3, and 4.
 - D. 2 and 3.
 - E. 4 only.

55. Harry Ingram purchased ten listed bonds (Widget Corp 8.00s10/1/99) on June 24, 1995, at a market asked price of 95. His transaction cost from the trade was \$100. He paid his broker \$9,800 as a consequence of the trade. He asks you to explain the details of his purchase. You reply that:
1. His purchase cost included \$9,500 for the bonds, \$100 for broker commission and \$200 as mark-up by the trade specialist.
 2. His broker will report \$400 on Form 1099-INT as 1995 taxable interest on these bonds. His taxable interest income from the bonds for 1995 was \$400.
 3. His purchase cost included \$9,500 for the bonds, \$100 for broker commission and \$200 as accrued interest.
 4. His broker reported \$400 on form 1099-INT as 1995 taxable interest on these bonds. His taxable interest income from the bonds for 1995 was \$200.
 5. His purchase cost included \$9,500 for the bonds, \$100 for broker commission and \$200 charged in error by the brokerage house.
- A. 3 and 4.
 - B. 1 and 2.
 - C. 1 and 4.
 - D. 2 and 3.
 - E. 2 and 5.
56. Three investors wish to start a manufacturing business. The business is expected to generate a large income, which it will reinvest for many years. Investor #1 has substantial assets that he plans to contribute to the business. Investor #1 is also concerned about showing too much business income on his personal return. Which business structure(s) would be most appropriate for the business?
1. A limited partnership with Investor #1 as the limited partner.
 2. A business trust with all three as equal interests.
 3. An S corporation with all three as equal shareholders.
 4. A C corporation with all three as shareholders.
- A. 1, 2, and 3.
 - B. 1 and 3.
 - C. 2 and 4.
 - D. 4 only.
 - E. 1, 2, 3, and 4.

57. Regarding the characteristics of insurance, which of the following is/are fundamental?
1. Probability (possibility and predictability of a loss).
 2. Law of large numbers.
 3. Transfer of risk from individual to group.
 4. Insurance is a form of speculation.
- A. 1 and 2.
 - B. 1, 2, and 4.
 - C. 1, 2, and 3.
 - D. 4 only.
 - E. 1, 2, 3, and 4.
58. Joe Jones comes to you, his CFP licensee, with a dilemma. His brother-in-law, Fred, asked to borrow \$10,000 to start a new business. What advice do you give Joe to help make this a successful transaction?
1. Make a formal agreement specifying the interest rate and repayment schedule.
 2. State in writing that this is a loan, not a gift, and have Fred sign the document.
 3. Explain to Joe his options in case of default.
 4. Make sure Joe approves of the business venture prior to making the loan.
- A. 1 and 4.
 - B. 2 and 3.
 - C. 2 and 4.
 - D. 1, 2, and 3.
59. The National Association of Insurance Commissioners is involved in the regulation of insurance by:
1. Direct involvement through the development of specific regulations for all states to follow.
 2. The regulation of the insurance commissioners of all states.
 3. (Indirectly) The exchange of information and preparation of recommendations.
 4. Assuring that all states insurance regulation is somewhat uniform.
 5. Accrediting state insurance regulatory offices.
- A. 1, 2, and 5.
 - B. 1 and 4.
 - C. 3 and 5.
 - D. 4 only.
 - E. 2, 3, and 4.

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60. To qualify for the marital deduction, qualified terminable interest property (QTIP) must meet which of the following conditions?
1. The surviving spouse must have a general power to appoint the property.
 2. All of the income must be paid out either to the surviving spouse or to the children of the decedent and the surviving spouse.
 3. The executor must make the QTIP election.
 4. The surviving spouse must be entitled to make lifetime gifts to family members directly from the QTIP.
- A. 1 and 2.
 - B. 1 and 3.
 - C. 2 and 4.
 - D. 3 only.
 - E. 1, 2, 3, and 4.
61. Your client is designing an educational investment program for her eight year-old son. She expects to need the funds in about ten years when her AGI will be approximately \$45,000. She wants to invest at least part of the funds in tax-exempt securities. Identify which investment(s) would yield tax-exempt interest on her federal return if the proceeds were used to finance her son's education.
1. Treasury bills.
 2. EE bonds.
 3. GNMA funds.
 4. Zero coupon Treasury bonds.
- A. 3 and 4.
 - B. 1, 3, and 4.
 - C. 2 and 3.
 - D. 2 and 4.
 - E. 2 only.

62. Doris Jenkins is a 71 year-old widow with a son and daughter ages 43 and 45 and six grandchildren. Doris has an estate currently worth \$572,000, which includes her home worth \$250,000 and a life insurance policy on her life with a face value of \$160,000. Her children are named as primary beneficiaries. Doris recently suffered a severe stroke that left her paralyzed on her right side. She is home from the hospital but her health will continue to decline and she will need to go into a nursing home within one year. The only estate planning she has done to date is to write a will in 1989 that left all her assets to her children equally. Of the following estate planning considerations, which is/are appropriate for Doris at this time?
1. Transfer ownership of her home to her children so it will not be counted as a resource should she have to go into a nursing home and apply for Medicaid.
 2. Execute a durable general power of attorney and a durable power of attorney for health care.
 3. Place all of her assets in an irrevocable family trust with her children as beneficiaries.
 4. Start a gifting program transferring assets up to the annual exclusion amount to each of her children and grandchildren.
- A. 1, 2, 3, and 4.
 - B. 2 and 3.
 - C. 1 and 4.
 - D. 4 only.
 - E. 2 only.

63. Jane Smith, age 56, has \$500,000 in an IRA rollover account from her previous employer's profit-sharing plan. She also receives a monthly retirement pension from her previous employer's qualified plan of \$30,000 per year. Jane needs an extra \$20,000 per year from her IRA in order to meet her living expenses until her social security payments begin at age 62. Which of the following is/are true?
1. Since Jane is under age 59½, she will pay a 10% penalty tax on any amounts withdrawn from her IRA.
 2. Jane will have to report the \$20,000 withdrawal as ordinary income on her personal income tax return.
 3. Jane can avoid the 10% penalty tax if she bases her withdrawal on the "substantially equal payment" method available to individuals under age 59½.
 4. The \$20,000 per year withdrawal from Jane's IRA will be subject to the 15% excise tax on "excess distributions" from qualified plans.
- A. 1 only.
 - B. 2 only.
 - C. 3 only.
 - D. 2 and 3.
 - E. 1 and 4.
64. Under the Consolidated Omnibus Budget Reconciliation Act (COBRA) of 1985, an employer is required to extend medical plan coverage to eligible members of the employee's family if the employee:
1. Dies.
 2. Retires.
 3. Divorces.
 4. Terminates employment (prior to retirement).
- A. 1, 2, and 3.
 - B. 1 and 3.
 - C. 2 and 4.
 - D. 4 only.
 - E. 1, 2, 3, and 4.

65. Which statement(s) is/are correct regarding generation skipping transfer tax (GSTT)?
1. GSTT is a flat tax.
 2. Each person is permitted a \$1 million exemption against generation skipping transfers.
 3. The GSTT does not apply because it was repealed.
 4. The GSTT was designed to prevent taxpayers from avoiding estate taxes as wealth transfers generation to generation.
- A. 1, 2, and 4.
B. 2 and 4.
C. 3 only.
D. 1 and 4.
E. 2 and 3.
66. Bruce, age 55, is the beneficiary of his mother's \$200,000 life insurance policy. The insurer has requested him to select a settlement option for payment of the proceeds. What factors should he consider before making the election?
1. His current income needs.
 2. His asset management ability.
 3. His net worth.
 4. His estate planning goals.
 5. His tax liability on the \$200,000.
- A. 1, 2, 3, and 5.
B. 2 and 4.
C. 1 only.
D. 3, 4, and 5.
E. 1, 2, 3, and 4.

Instructions: In this section of the examination, you are presented with brief sets of facts, followed by two or more multiple choice questions. Choose the one best answer to each question.

Mini Case I

Bill Jones, age 35, comes to see you because he has just been diagnosed with a terminal illness. His doctor told him he will not be able to work more than another 6 months and that his life expectancy is only 12-18 months. Bill also tells you that he has always been self-employed and with the exception of the last two years, has never paid into Social Security.

67. What benefits will be available to Bill and his family from Social Security as a result of his disability?

1. Medicare Part A.
2. Medicare Part B.
3. Monthly disability benefit.
4. Lump-sum disability benefit.
5. Monthly benefit to spouse.
 - A. 1, 2, and 3.
 - B. 3 and 5.
 - C. 1, 2, and 4.
 - D. 3 only.
 - E. None of the above.

68. What benefits will be available to Bill and his family from Social Security as a result of his death?

Assume his wife is also 35 years old.

1. Monthly survivor's benefit for the worker's child, under age 18 (or age 18 if the child is a full-time high school or elementary school student).
2. Monthly survivor's benefit for the worker's spouse, or former spouse, who is caring for a dependent child under age 16 who is eligible for benefits.
3. Monthly survivor's benefit for the worker's spouse until age 65.
4. Lump-sum death benefit of \$255 for the worker's spouse or child.
 - A. 1, 2, and 3.
 - B. 1, 2, and 4.
 - C. 3 and 4.
 - D. 1 and 2.

Mini Case II

Joe is considering taking a position with a new employer at a salary of \$150,000. His salary would make him a highly compensated employee in the new company. His previous employer, where he also earned \$150,000, has been making the maximum allowed contributions to a money purchase plan. The new company has a 401(k) plan. Joe wishes to continue the highest possible level of pre-tax deferred savings for retirement.

69. Identify all of the options available to Joe through the new employer's 401(k) plan.
1. Have salary deferrals made in his new 401(k) plan equal to the amounts his previous employer contributed to his profit-sharing plan.
 2. Take advantage of employer matching in the 401(k) plan, if available.
 3. Have the employer make qualified non-elective contributions to his account, if available.
 4. Contribute the maximum allowable through salary deferral.
 - A. 1 and 2.
 - B. 1, 2, and 3.
 - C. 2 and 4.
 - D. 2, 3, and 4.
 - E. 3 and 4.
70. Assume that Joe participates in a deferred, non-qualified compensation plan offered by his new employer but also wishes to explore other options for maximizing his retirement savings. Identify the option(s) below that might be feasible.
1. Invest in a flexible premium, deferred annuity.
 2. Make annual contributions to an IRA on a pre-tax basis.
 3. Make annual contributions to an IRA on an after-tax basis.
 - A. 1 and 2.
 - B. 1 and 3.
 - C. 2 only.
 - D. 3 only.
 - E. 1 only.

Mini Case III

Mr. and Mrs. Jones, own 640 acres of farmland deeded as "joint tenants, not as tenants in common." Currently, the land is appraised at \$3,000 per acre and continues to escalate annually in value. In addition, Mr. Jones holds a \$250,000 CD in his name only, and Mrs. Jones holds a \$250,000 CD in her name only. Mr. and Mrs. Jones have no debts. Mrs. Jones' last will and testament provides that "all of my assets at my death shall be divided in three equal portions among my children and my husband."

71. Mrs. Jones dies unexpectedly, leaving her husband and two children as her sole heirs. Which of the following statements is true?
- A. The children will inherit two-thirds of Mrs. Jones' interest in the CD and her 50% interest in the farm.
 - B. The children will inherit two-thirds of Mrs. Jones' interest in the CD and no interest in the farm.
 - C. The children will inherit two-thirds of Mrs. Jones' interest in the CD and two-thirds of her 50% interest in the farm.
 - D. The children will inherit a statutory interest in the CD and the farm.
 - E. The children's share of Mrs. Jones' CD and her 50% interest in the farm are subject to probate.
72. Two weeks after Mrs. Jones' death, Mr. Jones dies, and his will provides that, "I hereby give all my real property to my brother James, and I give all my personal property to my children, share and share alike." Which one of the following statements is true?
- A. The children will inherit Mr. Jones' CDs and his interest in the farm.
 - B. The children will inherit Mr. Jones' CDs and none of his interest in the farm.
 - C. The children will inherit no interest in either Mr. Jones' CD or the farm.
 - D. Mr. Jones' CDs are subject to probate, but Mr. Jones' farm interest is not subject to probate.
 - E. Neither the CDs nor Mr. Jones' interest in the farm are subject to probate.

Mini Case IV

Smith invests in a limited partnership that requires an outlay of \$9,200 today. At the end of years 1 through 5, he will receive the after-tax cash flows shown below. The partnership will be liquidated at the end of the fifth year. Smith is in the 28% tax bracket.

<u>YEARS</u>	<u>CASH FLOWS</u>	
0	(\$9,200)	CF ₀
1	\$600	CF ₁
2	\$2,300	CF ₂
3	\$2,200	CF ₃
4	\$6,800	CF ₄
5	\$9,500	CF ₅

73. The after-tax IRR of this investment is:

- A. 17.41%.
- B. 19.20%.
- C. 24.18%.
- D. 28.00%.
- E. 33.58%.

74. Which of the following statements is/are correct?

1. The IRR is the discount rate, which equates the present value of an investment's expected costs to the present value of the expected cash inflows.
 2. The IRR is 24.18% and the present value of the investment's expected cash flows is \$9,200.
 3. The IRR is 24.18%. For Smith to actually realize this rate of return, the investment's cash flows will have to be reinvested at the IRR.
 4. If the cost of capital for this investment is 9%, the investment should be rejected because its net present value will be negative.
- A. 2 and 4.
 - B. 2 and 3.
 - C. 1 only.
 - D. 1, 2, and 3.
 - E. 1 and 4.

Mini Case V

The tax bracket and holdings of your client are as follows:

- Federal tax bracket = 33%

Investment*	Annual Income	June 30, Last Year Purchase Price	June 30, This Year Market Price
Money fund	\$6,500	\$100,000	\$100,000
11% T bonds	\$11,000	\$100,000	\$140,000
S&P Index fund	\$6,000	\$100,000	\$160,000
Computer stock fund	\$3,000	\$100,000	\$ 85,000

*There have been no capital gains distributions.

75. During the 12 months from June 30th, last year, through June 30th, this year, the portfolio earned, in annual yield and before-tax appreciation, respectively:

- A. 5.5% and 17.5%.
- B. 5.5% and 21.3%.
- C. 6.6% and 17.5%.
- D. 6.6% and 21.3%.

76. The question was deleted by the Board due to ambiguity.

Mini Case VI

Ginny is a sole proprietor. She wants to provide 60% of salary disability coverage to JoAnna, her employee who is in a 35% combined tax bracket. JoAnna's W-2 wages are \$40,000 and Ginny's annual contribution to her qualified profit-sharing account on JoAnna's behalf is \$4,000.

77. Ignoring cost of living adjustments or any possible Social Security benefits, calculate JoAnna's net-of-tax monthly disability payment if Ginny pays the disability premium and JoAnna's tax bracket during disability remains at 35%.
- A. \$1,300.
 - B. \$1,430.
 - C. \$2,000.
 - D. \$2,200.
78. Ignoring cost-of-living adjustments or any possible Social Security benefits, calculate JoAnna's net-of-tax monthly disability benefit if JoAnna pays the disability premium and JoAnna's tax bracket during disability remains at 35%.
- A. \$1,300.
 - B. \$1,430.
 - C. \$2,000.
 - D. \$2,200.

Mini Case VII

John Rivera owns a \$300,000 level-term life policy that he purchased five years ago. He has paid premiums of \$500/year for the past five years. He also owns a \$100,000 whole life policy that he purchased fifteen years ago. He has paid premiums of \$2,000 per year for the past 15 years, and now the policy has a cash surrender value of \$40,000. Over the years, the whole life policy has paid cash dividends to John. The cumulative dividends paid to John since inception totals \$5,000.

79. John has decided to cancel his \$300,000 level-term policy. Which statement is true?
- A. John has a taxable gain of \$2,500.
 - B. John has a taxable gain of \$297,500.
 - C. John would have no taxable gain.
 - D. John would have a taxable gain only if he died while the insurance was in force.
80. John has decided to cancel his \$100,000 whole life policy. Which statement is true?
- A. John has a taxable gain of \$10,000. This gain will be treated as a long-term capital gain.
 - B. John has a taxable gain of \$10,000. This gain will be treated as ordinary income.
 - C. John has a taxable gain of \$70,000. This gain will be treated as ordinary income.
 - D. John has no taxable gain.
81. Assume the same facts as above, but assume that the whole life policy is a participating policy and has paid John \$5,000 in dividends since inception. Which statement is true?
- A. The cash dividends received by John to date are treated as taxable.
 - B. If John died today, his beneficiary would receive a death benefit of \$95,000 from the whole life policy.
 - C. The cash dividends received by John to date are treated as non-taxable.
 - D. The cash dividends received by John should have been reported as a long-term capital gain on his personal income tax return in the year they were paid.

Mini Case VIII

Patricia Wilson's business is having its first anniversary. The business has been able to secure several profitable contracts, which has allowed Pat to hire two full-time assistants. Pat utilized independent contractors for other services. Pat would like to plan for her future security. She also wants to set up benefits for her two assistants but on a contributory basis. She is, however, concerned about having enough cash flow for the continued growth of the company, unforeseen business obstacles, and the increase in her personal income taxes.

82. Which of the following is/are also (an) appropriate reason(s) to recommend the establishment of a retirement plan for Pat's company given the objectives and circumstances described?
1. A pension plan would allow Pat to save for her own retirement.
 2. The tax savings from the pension plan contributions would help to offset the cost of this employee benefit.
 3. A retirement plan would give the appearance of business stability and would be an asset in the securing of business loans to meet growth and cash flow needs.
- A. 1 only.
 - B. 2 only.
 - C. 1 and 3.
 - D. 1 and 2.
 - E. 1, 2, and 3.
- *83. Of the following types of retirement plans, which would be the most appropriate for Pat's business?
- A. 401(k) plan.
 - B. Money purchase pension plan.
 - C. Defined benefit plan.
 - D. Profit-sharing plan.
 - E. Salary reduction simplified employee pension (SARSEP).

Mini Case IX

Jack, who had never married, died last year. Two years before his death he paid gift tax of \$15,000 as a result of making the following gifts (these were the only gifts he made that year).

- Stock worth \$40,000 to Mickey
- A \$300,000 (proceeds value) life insurance policy on his life to Molly. (The policy was worth \$5,000 at the time of transfer.)

At Jack's death, the stock had increased in value to \$70,000 and the life insurance company paid the \$300,000 to Molly. Consider the two transfers and the gift taxes paid when answering the following questions.

84. By how much will Jack's gross estate be increased?

- A. \$15,000.
- B. \$60,000.
- C. \$315,000.
- D. \$355,000.

*85. The adjusted taxable gifts will be:

- A. Zero.
- B. \$30,000.
- C. \$40,000.
- D. \$370,000.

86. If the two gifts had been made four years before Jack's death, how much would his gross estate have been increased by?

- A. Zero.
- B. \$15,000.
- C. \$30,000.
- D. \$300,000.

CFP® CERTIFICATION EXAMINATION QUESTIONS

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Directions: This part consists of problem sets. Each problem set consists of a brief fact pattern followed by two or more questions or incomplete statements. Four or five suggested answers or completions follow each question or incomplete statement. Select one best answer or completion for each question.

- I. Bond A has a 6% annual coupon and is due in 2 years. Its value in today's market is \$900.
Bond B has a 10% annual coupon and is due in 4 years. It is priced to yield 12%.
Bond C is a 9% zero-coupon bond priced to yield 11% in 8 years.
1. The yield to maturity of Bond A is closest to:
- A. 9.90%.
 - B. 10.40%.
 - C. 10.90%.
 - D. 11.40%.
 - E. 11.90%.
2. Assuming that the duration of Bond A is 1.94 years, which of the following statements about the effect of a 1% decline in interest rates is true?
- A. Bond C, having a longer duration than Bond A, would have a larger percent increase in price than Bond A.
 - B. The percent change in price of a bond is independent of the duration of a bond.
 - C. It is not possible to determine the percent change in price of Bond A versus Bond C because the duration of Bond C is not given.
 - D. Bond A would have a greater percent change in price than Bond C because it has a shorter duration.
 - E. The percent change in the price of Bonds A and C is equal since it is not affected by duration.

“1999 Released Case Scenario and Multiple-Choice Questions”
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- II. A young couple (both age 30) comes to the financial planner with the desire for assistance in improving their family's financial position. They have two healthy children, ages 3 and 6. The husband is a foreman for a manufacturer of auto parts. His current salary is \$30,000 per year. The wife is a marketing professor for a state university. Her current salary is \$40,000 per year. The couple recently purchased a riverfront home for \$100,000 using their entire savings of \$20,000 as a down payment. In addition to an \$80,000 mortgage, the couple's only debt is an automobile loan having a balance of \$12,000. Both husband and wife have very good family health insurance from their employers. The wife has employer-paid life insurance equal to two times her annual salary.
3. The couple wants to start an investment program as soon as possible. To correct the weakness in their financial planning before beginning the investment program, they should:
1. Establish an emergency fund with stock mutual funds.
 2. Start a college savings fund for the children.
 3. Purchase disability insurance for the wife and the husband.
 4. Prepare wills for the wife and the husband.
 5. Secure credit life insurance for the auto loan.
 - A. 5 only.
 - B. 1 and 2 only.
 - C. 1 and 3 only.
 - D. 3 and 4 only.
4. When the couple is able to begin an investment program, they want to begin making investments for their retirement and their children's education. All of the following actions will help accomplish their goals in a tax-efficient manner except:
- A. Investing in individual Roth IRAs.
 - B. Investing through a 403(b) program for the wife.
 - C. Investing in a growth and income mutual fund.
 - D. Investing in education IRAs for each child.

III. Grantor has established a trust, naming a bank as trustee. Pursuant to the terms of the trust document, Grantor is to receive all of the income generated by the trust assets during his life. Grantor may withdraw assets from the trust or place additional assets into it. The assets placed into the trust consist of Grantor's mutual fund portfolio, personal residence, a rental property located in another state, and two installment notes held by Grantor. Upon Grantor's death, all of the assets remaining in the trust are to be distributed to Grantor's two children.

*5. Which of the following statements is/are correct?

1. Upon the transfer of the installment notes to the trust, any deferred gain will be recognized as taxable income.
2. After the transfer, the income from the mutual funds will be reported on Grantor's tax return.
3. Upon the transfer of the rental property to the trust, all excess prior years' depreciation will be recaptured.
4. After the transfer, the \$125,000 exclusion from capital gain remains available for the principal residence.
 - A. 4 only.
 - B. 1 and 3 only.
 - C. 2 and 4 only.
 - D. 1, 2, and 3 only.
 - E. 1, 2, 3, and 4.

6. Upon Grantor's death, the assets remaining in the trust will

1. Be included in Grantor's taxable estate.
2. Be subjected to the probate process.
3. Receive a new basis except for the installment notes.
4. Be distributed as directed by Grantor's will.
 - A. 4 only.
 - B. 1 and 3 only.
 - C. 1, 2, and 3 only.
 - D. 1, 2, 3, and 4.

IV. A client sold an apartment building last year for \$100,000, paying a sales commission of \$5,000 plus \$2,500 closing costs. The building originally cost \$80,000 20 years ago. Total straight-line depreciation of \$40,000 had been taken. The building had a mortgage of \$60,000 that was assumed by the buyer.

7. What is the seller's adjusted cost basis?

- A. \$32,500.
- B. \$37,500.
- C. \$40,000.
- D. \$52,500.

8. What is the purchaser's cost basis?

- A. \$70,000.
- B. \$92,500.
- C. \$100,000.
- D. \$107,500.

Directions: Four or five suggested answers or completions follow each question or incomplete statement. Select one best answer or completion for each question.

9. John Hedrick wants to pay one-half of the college costs for his daughter, Ruth. She will be attending a private college with annual costs of \$20,000 today. Ruth is 10 years old and will be starting college in 8 years. If these costs are expected to increase annually by 8%, how much will Mr. Hedrick need to provide for her first year of college?
- A. \$18,509.
 - B. \$23,409.
 - C. \$27,371.
 - D. \$37,019.
 - E. \$74,037.
10. One of your clients wants to know the maximum amount that might be allocated to her 401(k) account in 1998. She expects to earn \$40,000. You explain the possible sources of an annual addition to her account, including allocation of forfeitures from departing non-vested employees, and the limitation on that addition. The largest annual addition that could be made to her 401(k) account in 1998 is
- A. \$6,000.
 - B. \$8,000.
 - C. \$9,600.
 - D. \$10,000.
 - E. \$30,000.

11. The following set of newly issued debt instruments was purchased for a portfolio:

- Treasury bond
- Zero-coupon bond
- Corporate bond
- Municipal bond

The respective maturities of these investments are approximately equivalent. Which one of the investments in the preceding set would be subject to the greatest relative amount of price volatility if interest rates were to change quickly?

- A. Treasury bond.
- B. Zero-coupon bond.
- C. Corporate bond.
- D. Municipal bond.

*12. Which of the following statements about S corporations is true?

- A. S corporation status is automatic if there are fewer than 75 shareholders.
- B. S corporations are prohibited from having more than one class of stock.
- C. S corporations are prohibited from earning passive income.
- D. S corporations may have non-resident aliens as shareholders.

13. The best life insurance policy for the payment of federal estate taxes for a 50-year-old couple with illiquid assets is:

- A. An individual whole-life policy on each spouse on a cross-ownership basis.
- B. A joint first-to-die life insurance policy owned jointly.
- C. A joint last-to-die life insurance policy owned by the spouse with the larger estate.
- D. A joint and last-to-die life insurance policy owned by the spouse with the smaller estate.
- E. A joint and last-to-die life insurance policy owned by an irrevocable trust.

14. Which one of the following factors would be the strongest indication that interest rates might rise?
- A. Selling of dollar-denominated assets by foreign investors.
 - B. Decreasing United States government deficits.
 - C. Decreasing rates of inflation.
 - D. Weak credit demand by the private sector of the United States economy.
15. What is the main responsibility of the underwriting department of a life insurance company?
- A. To guard against adverse selection.
 - B. To set a limit on the amount of insurance issued.
 - C. To set adequate insurance rates.
 - D. To avoid exposures that could result in loss.
16. Which of the following best describes the investment characteristics of a high-quality long-term municipal bond?
- A. High inflation risk; low default risk.
 - B. Low inflation risk; high market risk.
 - C. Low inflation risk; low default risk.
 - D. High inflation risk; high market risk.
17. Robert Smith asks for your help in preparing his cash flow statement. He tells you that his salary before taxes is \$250,000 and that he has no mortgage on his home. Which of the following statements is true about Robert's cash flow statement?
- A. The value of the home would be an income source since there is no mortgage.
 - B. The value of the home would be an asset.
 - C. The taxes on his salary would be a liability.
 - D. The taxes on his salary would be an expense.

18. Billy Smith, age 55, has been a member of the union for 30 years, and as a result, has been excluded from his employer's retirement plan. Billy has been offered a management position with his firm, which will make him eligible to participate in the company's 401(k) plan. Billy's objective is to retire at age 65 with \$2,000 in monthly retirement income, exclusive of Social Security benefits. He assumes a life expectancy of age 95. The union retirement plan will provide him with \$1,000 monthly. (There are no matching contributions from Billy's employer to the 401(k) plan and, his income is adequate to have the required level of contributions fall within the deferral limits of the 401(k) plan. Contributions and payments, as appropriate, are made at the beginning of each month.) If the return in the company's 401(k) plan is 10%, what monthly amount will Billy have to contribute to that plan for 10 years to meet his objective?
- A. \$556.
 - B. \$566.
 - C. \$576.
 - D. \$747.
 - E. \$1,113.
- *19. A client becomes age 70½ on October 1 of this year and must receive a minimum distribution from his IRA account, which had a value at the beginning of the current year of \$48,000. His spouse, age 63, is the beneficiary of the IRA account. Their combined life expectancy according to IRS tables is 24 years. If the client takes a \$1,000 distribution by next April 1, what will be the tax penalty?
- A. \$0.
 - B. \$100.
 - C. \$150.
 - D. \$500.
 - E. \$1,000.

20. Jasmine has a large paper profit in her Amalgamated Corporation shares, currently at 46. She is happy with the stock but realizes that a good thing cannot go on forever. If she is willing to sell at 50, what strategy could you recommend to her?
- A. Buy \$50 call options.
 - B. Sell \$50 call options.
 - C. Buy \$50 put options.
 - D. Sell \$50 put options.
21. "Stock prices adjust rapidly to the release of all new public information." This statement is an expression of which one of the following ideas?
- A. Random walk hypothesis.
 - B. Arbitrage pricing theory.
 - C. Semi-strong form of the efficient market hypothesis.
 - D. Technical analysis.
- *22. Before her death, LaDonna Kiniston, age 74, gave her three grandchildren some money for their private school education. She paid \$12,000 to the school for Jake's tuition and gave a like amount to Sarah and Nicole. What would be the adjusted taxable gifts calculated in her estate taxes?
- A. \$0.
 - B. \$4,000.
 - C. \$6,000.
 - D. \$16,000.
 - E. \$36,000.

23. Mrs. Bailey dies leaving her entire \$3.2 million estate to her penniless husband, Mr. Bailey. Their estate goes to their children at his death. He has terminal cancer with a life expectancy of 1-2 years. The alternative valuation date computes Mrs. Bailey's entire estate equal to \$3.0 million. Select the postmortem technique he should utilize to reduce the overall estate tax liability of both estates.
- A. Elect to use date-of-death valuation.
 - B. Elect to use the alternate valuation method.
 - C. Disclaim \$625,000 and elect to use the alternate valuation method.
 - D. Disclaim \$1,500,000 and elect to use the alternate valuation method.
 - E. Disclaim \$3,000,000 and elect to use the alternate valuation method.
24. Which of the following is a benefit provided by Medicare?
- A. Hospice benefits for terminally ill persons.
 - B. A stop-loss limit for annual medical expenses in excess of \$2,500.
 - C. Coverage for custodial care.
 - D. Coverage for prescription drugs that can be self-administered.
25. What is the early withdrawal penalty for a SIMPLE plan during the 2-year period beginning on the date the employee first participated in the SIMPLE plan?
- A. 10%.
 - B. 15%.
 - C. 20%.
 - D. 25%.
26. Assuming that the current market yield for similar risk bonds is 8%, determine the discounted present value of a \$1,000 bond with a 7.5% coupon rate, which pays interest semiannually and matures in 17.5 years.
- A. \$504.68.
 - B. \$539.78.
 - C. \$953.34.
 - D. \$968.96.
 - E. \$1,653.26.

27. Calculate the maximum 1998 contribution for an employee earning \$140,000 annually, working in a company with the following retirement plans: a 401(k) with no employer match and a money-purchase pension plan with an employer contribution equal to 12% of salary.

- A. \$16,800.
- B. \$26,300.
- C. \$26,800.
- D. \$30,000.
- E. \$35,000.

28. Given the following diversified mutual fund performance data, which fund had the best risk-adjusted performance if the risk-free rate of return is 5.7%?

<u>Fund</u>	<u>Average Annual Return</u>	<u>Standard Deviation of Annual Return</u>	<u>Beta</u>
A	.0782	.0760	0.950
B	.1287	.1575	1.250
C	.1034	.1874	0.857
D	.0750	.0810	0.300

- A. Fund B because the annual return is highest.
- B. Fund A because the standard deviation is lowest.
- C. Fund C because the Sharpe ratio is lowest.
- D. Fund D because the Treynor ratio is highest.
- E. Fund A because the Treynor ratio is lowest.

29. Judy Green, a CFP licensee, has proof that Mary Clark, another CFP licensee in her office, has utilized clients' funds under management to cover gambling debts. Mary returned the funds to the clients' accounts and made them whole, including the earnings that would have accrued during the time that the funds were withdrawn. Under the *Code of Ethics and Professional Responsibility and Disciplinary Rules and Procedures*, Judy is obligated to
- A. Report Mary's action to the local CFP organization for proper processing.
 - B. Report Mary's action to the CFP Board of Examiners because Mary has violated the Professionalism Principle.
 - C. Report Mary's action to the CFP Board because Judy is bound by the CFP Code of Ethics and Professional Responsibility to do so.
 - D. Not report Mary's action to the CFP Board because Judy would violate the Confidentiality Principle.
 - E. Not report Mary's action to the CFP Board because Mary made full restitution and the clients involved were not harmed by Mary's action.
30. To immunize a bond portfolio over a specific investment horizon, an investor would do which of the following?
- A. Match the maturity of each bond to the investment horizon.
 - B. Match the duration of each bond to the investment horizon.
 - C. Match the average weighted maturity of the portfolio to the investment horizon.
 - D. Match the average weighted duration of the bond portfolio to the investment horizon.
31. Which of the following employee fringe benefits would be taxable to the employee?
- A. Business use of an employer-provided automobile.
 - B. Employee of an airline flying standby from Los Angeles to San Francisco.
 - C. Benefits of de minimis value.
 - D. Monthly dues to the local health club paid by the employer.
 - E. A 10% employee discount on department store merchandise.

32. Many employers are now making flexible spending accounts (FSAs) available to employees. Which of the following statements concerning the nature of these accounts is incorrect?
- A. The balance in an employee's FSA can be carried forward or exchanged for cash if unused for expenses incurred.
 - B. An FSA is technically a cafeteria plan that can be used by itself or as part of a broader cafeteria plan.
 - C. A separate FSA salary reduction must be made for each type of eligible benefit.
 - D. A salary reduction for an FSA will lower an employee's income for social security tax purposes if the employee earns less than the social security wage base.
33. A successful architect wants to purchase disability income insurance. She is concerned about becoming totally disabled, but also about a reduction in income if she is obliged to reduce her workload because of a less-than-total disability. To satisfy these concerns, which of the following should be included in her disability income coverage?
- A. Residual disability benefits.
 - B. A change-of-occupation provision.
 - C. Dismemberment benefits.
 - D. A relation of earnings-to-insurance provision.
34. John and Mary Meyers have a combined estate of \$900,000 including a \$250,000 life insurance policy on John's life. The Meyers have two children. John prefers Mary receive the income from the policy if he dies but wants the proceeds to go to his children after her subsequent death. John and Mary have recently executed wills that contain unified credit trusts. What is the best beneficiary designation for John's life insurance policy?
- A. His wife Mary.
 - B. His two children.
 - C. A charitable remainder trust.
 - D. His testamentary trust.
35. In analyzing the financial statements of a client's business, you notice that the collection period for accounts receivable has been increasing. What does this increase suggest about the firm's credit policy?
- A. The firm's current ratio is also increasing.
 - B. The collection period has no relationship to a firm's credit policy.
 - C. The firm is losing qualified customers.
 - D. The credit policy is too lenient.

36. Your client's federal marginal tax rate is 36%, and the state marginal rate is 7%. The client does not itemize deductions on his federal return and is considering investing in a municipal bond issued in his state of residence which yields 5%. What is the taxable equivalent yield?
- A. 3.20%.
 - B. 4.65%.
 - C. 5.38%.
 - D. 7.81%.
 - E. 8.77%.
37. Johanna Olsen, CFP, is duly registered under the Investment Advisers Act of 1940. For which one of the following activities would this planner be in violation of the act?
- A. She received, with the client's knowledge, both a fee for advice given to the client and a commission from client transactions.
 - B. She included the cost of preparing the client's income tax returns as part of the annual fee charged the client.
 - C. She gave clients planning advice that was not achievable, given the current economic conditions.
 - D. She distributed to clients the written disclosure brochure 2 weeks after an investment advising contract was duly signed.

38. Which of the following statements is correct with regard to the use of an arbitration clause in an investment advisory agreement?
- A. The SEC and NASD require arbitration if voluntary negotiation fails.
 - B. The SEC requires that such a clause be contained in any investment advisory agreement.
 - C. The NASD requires that such a clause stipulate that arbitration must be conducted by non-industry organizations.
 - D. The clause must allow state regulation to take precedence over federal regulation.
39. A client provides a current personal balance sheet to the financial planner during the initial data-gathering phase of the financial planning process. This financial statement will enable the financial planner to gain an understanding of all of the following except the:
- A. Diversification of the client's assets.
 - B. Size of the client's net cash flow.
 - C. Client's liquidity position.
 - D. Client's use of debt.
40. Your client is contemplating the sale of some of her holdings in her employer's stock. The stock was acquired in four separate purchases as follows:

Date	Shares	Cost Per Share	Cost
June 1, 1986	200	\$10	\$2,000
June 1, 1988	200	\$18	\$3,600
June 1, 1990	200	\$12	\$2,400
June 1, 1992	200	\$20	\$4,000
Total	<u>800</u>		<u>\$12,000</u>

She wants to know the least amount of gain she would be required to report if she sold 500 shares for \$12,500. Compute this gain.

- A. \$500.
- B. \$3,700.
- C. \$4,300.
- D. \$5,000.
- E. \$5,700.

41. Assuming neither person has used any of his/her unified credit, what is the maximum amount a married couple can give to a single, third party donee in 1998 without paying federal gift tax?
- A. \$625,000.
 - B. \$635,000.
 - C. \$1,250,000.
 - D. \$1,260,000.
 - E. \$1,270,000.
42. If a client's primary goal in making lifetime gifts to his children is to lower his estate taxes, he should make gifts of property that:
- A. Are expected to depreciate significantly in the future.
 - B. Are expected to appreciate significantly in the future.
 - C. Have already depreciated significantly.
 - D. Have already appreciated significantly.
43. The maximum retirement benefit a participant in a target-benefit plan can actually receive depends on the:
- A. Initial actuarial computation according to the plan's formula.
 - B. Amount of contributions determined in reference to the targeted benefit.
 - C. Maximum annual additional amounts.
 - D. Value of the participant's account at retirement.
 - E. Present value of the actuarially determined target benefit.
44. A client recently purchased a new home from a builder for \$150,000 including the lot valued at \$40,000. How much insurance would you recommend that your client purchase to cover full replacement of the house in the event of a loss?
- A. \$88,000.
 - B. \$110,000.
 - C. \$120,000.
 - D. \$150,000.

45. In determining the allowable annual additions per participant to a defined-contribution pension plan account for 1998, the employer may not include:
- A. Compensation exceeding \$30,000 (indexed).
 - B. Compensation exceeding \$160,000.
 - C. Compensation exceeding the defined-benefit limitation in effect for that year.
 - D. Bonuses.
46. Jill Smith is an agent acting as a buyer for Tom Jones, d/b/a JKL Auto Repair, a sole proprietorship. Her authority is limited to purchasing supplies and equipment up to \$5,000 in cost. Jill signs a promissory note borrowing \$5,000 from a third party. Tom Jones uses the funds for business purposes. Which of the following statements describes Tom Jones' responsibility for Jill Smith's action?
- A. Jones is not bound by Smith's actions since she lacked the actual authority to sign for the loan.
 - B. Jones is not bound by Smith's actions since she lacked the necessary power of attorney to sign for the loan.
 - C. Jones is not bound by Smith's actions since she lacked the express authority to sign for the loan.
 - D. Jones is bound by Smith's actions since he ratified her action by using the loan proceeds for his business.
 - E. Jones is bound by Smith's actions since she has the authority to purchase.
47. What is an appropriate standard estate planning strategy for married couples to minimize taxes over two deaths?
- A. Bequeath the entire estate to a trust, giving the surviving spouse a general power of appointment.
 - B. Bequeath the applicable exclusion amount to a qualified terminable interest property trust (QTIP) and the balance to the surviving spouse.
 - C. Bequeath the applicable exclusion amount to a bypass trust to take advantage of the unified credit at the first death.
 - D. Bequeath the applicable exclusion amount to the surviving spouse and the balance to the children.

48. A client, who is a sole proprietor, is going to give her best customers gifts as a token of her appreciation. If the client wants to deduct the full cost of the gifts, what is the maximum amount that she may spend on each customer's gift?
- A. \$25.
 - B. \$50.
 - C. \$100.
 - D. \$250.
49. Which of the following dispositions of IRC Section 1245 recapture property would result in the immediate recapture of some or all of previous depreciation deductions?
- A. A distribution by a partnership to its partners.
 - B. A like-kind exchange.
 - C. A disposition at death.
 - D. A sale for cash and an interest-bearing note.
50. John is a contractor who has just purchased a tractor for use in his business. John paid \$25,000 plus \$1,250 in sales tax for the tractor. The local municipality also imposes an annual personal property tax of \$500. The tractor has an expected useful life of 5 years. What is John's basis in the tractor for depreciation purposes?
- A. \$25,000.
 - B. \$25,500.
 - C. \$26,250.
 - D. \$26,750.
51. A cash basis taxpayer includes income from a service business when:
- A. The services are performed.
 - B. The client is invoiced for the services.
 - C. The client's check is deposited in the bank.
 - D. The client's check is received.

52. Which of the following is true about property transferred between spouses, or former spouses, incident to a divorce?
- A. Property transfer within 18 months of the divorce will have a basis equal to its fair market value at the date of transfer.
 - B. Property transfer will not be treated as if it were acquired by gift and will recognize gain or loss to the transferor.
 - C. Property transfer will be treated as if it were acquired by gift and the basis carried over to the transferee will be the lower of the fair market value or the transferor's basis.
 - D. Property transfer will be treated as if it were acquired by gift and the transferor basis in the property will be carried over to the transferee.
53. Your client, who has a taxable income of \$200,000, is concerned about being subject to the alternative minimum tax (AMT). The following income and deductions were included in computing taxable income. Select the one item that may be added to (or subtracted from) regular taxable income in calculating the AMT.
- A. A long-term capital gain of \$100,000.
 - B. A cash contribution to your client's church of \$25,000.
 - C. Dividend income of \$100,000.
 - D. Qualified housing interest of \$25,000.
 - E. A state income tax deduction of \$25,000.
54. Sam, age 95, transferred \$600,000 of common stock to an irrevocable trust. Sam provides that the income from the trust is payable to himself for life, and upon his death, the trust corpus will pass to his sister. The trust prohibits Sam from changing the trust beneficiaries. If Sam dies 1 year from now when the value of the trust assets is \$650,000, how much of the trust will be included in Sam's gross estate?
- A. \$0; because Sam cannot change the beneficiaries.
 - B. \$25,000; because of Sam's unified credit.
 - C. \$650,000; because Sam has the right to the trust's income for life.
 - D. \$600,000; because Sam created an irrevocable trust.

55. Your client's employer has recently adopted a group universal life insurance plan. The advantages of such a plan for your client typically include all of the following except that
- A. It allows employees to borrow or withdraw cash.
 - B. It provides an opportunity to continue coverage after retirement.
 - C. The entire premium cost is borne by the employer.
 - D. It provides flexibility in designing coverage to best meet individual needs.
56. Sam and Sue paid \$100,000 for their home 5 years ago. Its fair market value was \$150,000 when Sam died. What was Sue's basis in the home after Sam's death if the home was held as community property?
- A. \$50,000.
 - B. \$75,000.
 - C. \$100,000.
 - D. \$125,000.
 - E. \$150,000.
57. A Certified Financial Planner licensee obtains a new client. During the fact-finding process, the CFP licensee discovers that the client's previous advisor, also a CFP licensee, had filed several tax forms incorrectly with computational errors. The CFP licensee's initial duty to the client should be which of the following?
- A. Contacting the other financial planner.
 - B. Contacting the CFP Board.
 - C. Contacting the IRS.
 - D. Informing the client of the situation.

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58. Mrs. Smith is an 80-year-old widow whose liquid assets are on deposit at a small FDIC-insured bank. She has the following on deposit:

<u>Asset</u>	<u>Ownership</u>	<u>Balance</u>
Various Certificates of Deposit	Mrs. Smith	\$75,000
Money Market Deposit Account	Mrs. Smith	\$50,000
IRA Rollover	Mrs. Smith	\$200,000
Passbook Savings	Joint with son	\$25,000
Checking Account	Joint with daughter	\$25,000

How much is currently insured by the FDIC?

- A. \$100,000.
 - B. \$150,000.
 - C. \$250,000.
 - D. \$375,000.
59. Bob, age 47, has worked for XYZ Company the past 12 years. XYZ Company has lost a major contract and must begin downsizing immediately. Bob was laid off yesterday. What should Bob do first?
- A. File for unemployment benefits.
 - B. Rollover his company 401(k) plan.
 - C. Convert disability coverage under COBRA provisions.
 - D. Notify the bank holding the mortgage on his house.

60. Which of the following statements concerning the choice of an entity versus a cross-purchase partnership buy-sell agreement funded with insurance is false?

- A. The use of existing insurance to fund the agreement causes a transfer-for-value problem if an entity agreement is selected, but does not cause this problem if a cross-purchase approach is used.
- B. A cross-purchase should be selected if the surviving partners expect to sell their interests during their lifetimes.
- C. An entity approach may solve the affordability problem if one partner is significantly older than the others.
- D. An entity agreement becomes more desirable as the number of partners included in the agreement increases.

Directions: This part consists of combination items. Each item contains a question or incomplete statement followed by a list of numbered responses. Select one best answer for each item that includes the correct combination of responses from the numbered list.

61. A tenancy by the entirety may be terminated in which of the following ways?
1. Death, whereby the survivor takes the entire estate.
 2. Mutual agreement.
 3. Divorce, which converts the estate into a tenancy in common or a joint tenancy.
 4. Severance, whereby one spouse transfers his or her interest to a third party without the consent of the other spouse.
- A. 4 only.
 - B. 1 and 3 only.
 - C. 2 and 4 only.
 - D. 1, 2, and 3 only.
 - E. 1, 2, 3, and 4.
62. Which of the following investment vehicles are most appropriate for an emergency fund for a family with \$12,000 a year discretionary income?
1. Balanced mutual fund.
 2. Line of credit.
 3. Money market mutual funds.
 4. Laddered CDs set to mature every 6 months.
- A. 1 and 2 only.
 - B. 2 and 4 only.
 - C. 3 and 4 only.
 - D. 1, 2, and 3 only.

63. Mortgage-backed securities may contain which of the following risks?
1. Purchasing power risk.
 2. Interest rate risk.
 3. Prepayment risk.
- A. 2 only.
 - B. 1 and 2 only.
 - C. 1 and 3 only.
 - D. 1, 2, and 3.
64. Alisha Sheridan, a CFP licensee and fee-only financial planner, has assisted Roger Regate, a self-employed physician, in tax and investment planning during the year. Identify the schedule(s) on which Alisha's fee may be deductible by Roger on his federal income tax return.
1. Schedule A--itemized deductions.
 2. Schedule C--profit or loss from business.
 3. Schedule D--capital gains and losses.
- A. 1 only.
 - B. 2 only.
 - C. 3 only.
 - D. 1 and 2 only.
 - E. 1, 2, and 3.
- *65. Which of the following statements is/are characteristics of tax-sheltered annuities (TSAs)?
1. Salary reduction contributions are not reported as W-2 income and are not subject to Social Security tax.
 2. Maximum salary deferral limit is \$10,000 for a newly hired employee.
 3. Employer contributions are deductible.
 4. Loans and "catch-up" contributions may be permitted.
- A. 4 only.
 - B. 1 and 3 only.
 - C. 2 and 4 only.
 - D. 1, 2, and 3 only.
 - E. 1, 2, 3, and 4.

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66. A premature distribution from a qualified retirement plan is allowed at age 52 without a 10% additional tax when a participant
1. Becomes obligated for payment of plan benefits to an alternate payee under a qualified domestic relations order (QDRO).
 2. Separates from service and takes an accepted form of systematic payment.
 3. Remains with current employer but elects to take systematic payments over the life of the participant and spouse.
- A. 1 only.
 - B. 3 only.
 - C. 1 and 2 only.
 - D. 1, 2, and 3.
67. A financial planner's client has an IRA with a balance of \$140,000 as of January 1. On April 15 of the same year, the client withdraws the entire amount from the IRA and places it in a non-IRA CD for 60 days, earning 9% interest. On the 60th day, the client promptly and timely reinvests the principal of the CD in an IRA containing an aggressive growth fund. On September 15 of the same year, the client becomes dissatisfied with the return and the variability of the investment. The client wants a less risky investment and wants assurance that any IRA distribution will not be taxed at the time of the change. Which of the following is/are acceptable alternatives for the client?
1. Withdraw the funds and reinvest them within 60 days in an IRA that invests exclusively in Treasury instruments.
 2. Direct the trustee of the IRA to transfer the funds to another IRA that invests exclusively in Treasury instruments.
 3. Withdraw the funds and reinvest within 60 days in an IRA that is an index mutual fund holding common stocks with portfolio risk equal to the S&P 500.
- A. 1 only.
 - B. 2 only.
 - C. 2 and 3 only.
 - D. 1, 2, and 3.

68. Your client has the following beliefs about the allocation of forfeitures of contributions to employees who leave the company. Which of the following statements is/are correct?
1. Departing plan participants are entitled to their entire account balances regardless of the vesting schedule in effect.
 2. Forfeitures could be allocated to plan participants in exactly the same manner as the employer's contributions.
 3. Unless specific steps were taken to the contrary, the allocation of forfeitures in this company's plan over time would tend to discriminate in favor of the relatively few longer-hired and more highly paid employees.
 4. The company could use forfeitures to offset amounts it would otherwise contribute to employees' accounts.
- A. 2 only.
 - B. 1 and 2 only.
 - C. 1 and 4 only.
 - D. 3 and 4 only.
 - E. 2, 3, and 4 only.
69. You receive a phone call from an individual you have not spoken with previously. The caller is excited, just having heard that a new mutual fund is positioned to deliver large gains in the coming year. The caller wishes to purchase shares of the fund through you. Keeping in mind stages of the overall personal financial planning process, which of the following questions that addresses the first two stages of the financial planning process should you ask the caller?
1. What are your goals for this investment?
 2. What other investments do you have?
 3. What is your date of birth?
 4. Do you want your dividends reinvested?
- A. 1 and 3 only.
 - B. 2 and 4 only.
 - C. 1, 2, and 3 only.
 - D. 1, 2, and 4 only.

70. Which of the following are exemptions under the definition of “investment adviser”?
1. Banks that are not investment companies.
 2. Accountants or lawyers whose investment advice is “solely incidental” to the practice of their profession.
 3. Persons whose advice relates only to securities issued or guaranteed by the U.S. government.
 4. Publishers of financial publications that have regular and general circulation.
- A. 1 and 3 only.
 - B. 2 and 4 only.
 - C. 1, 2, and 4 only.
 - D. 1, 2, 3, and 4.
71. A local businessperson approaches a CFP licensee for assistance with an investment-related tax problem. The client's previous tax preparer had suggested the purchase of a variety of tax-advantaged investments to reduce the client's current and future tax burden. Time passed, the client's income dropped, and the tax laws changed. The client does not feel the tax preparer misrepresented the situation on the initial sale, but would still like to know what recourse is available with respect to the tax preparer. The CFP licensee should:
1. Explain to the client that this issue is beyond the scope of the CFP licensee's professional expertise.
 2. Advise the client that no recourse is available.
 3. Advise the client to contact an attorney.
 4. Contact the tax preparer.
- A. 4 only.
 - B. 1 and 3 only.
 - C. 2 and 4 only.
 - D. 1, 2, and 3 only.

72. Terry Underwood purchased a 15-year-old compact car with 100,000 miles for his teenage son who recently received his license. Which of the following auto insurance coverages should be included in the policy for this auto?
1. Part A - liability coverage.
 2. Part B - medical payments coverage.
 3. Part C - uninsured motorist coverage.
 4. Part D - damage to insured's auto.
 - A. 1, 2, and 3 only.
 - B. 1, 2, and 4 only.
 - C. 1, 3, and 4 only.
 - D. 2, 3, and 4 only.
73. In selecting insurance coverage for a client, the prudent planner should consult which of the following independent sources for determining company strength?
1. A.M. Best Reports.
 2. Standard and Poor's.
 3. Moody's Investors Services.
 4. Dun and Bradstreet.
 - A. 1 and 3 only.
 - B. 1 and 4 only.
 - C. 1, 2, and 3 only.
 - D. 2, 3, and 4 only.
74. Which of the following credentials permit an individual to appear before the IRS on behalf of a client?
1. Enrolled agent.
 2. Certified Public Accountant.
 3. Attorney.
 4. Certified Financial Planner licensee.
 - A. 2 and 3 only.
 - B. 2 and 4 only.
 - C. 1, 2, and 3 only.
 - D. 1, 3, and 4 only.

75. The duration of a bond is a function of its:

1. Current price.
 2. Time to maturity.
 3. Yield to maturity.
 4. Coupon rate.
- A. 1 and 3 only.
 - B. 2 and 3 only.
 - C. 2 and 4 only.
 - D. 1, 2, and 3 only.
 - E. 1, 2, 3, and 4.

76. Five years ago, Tom Mohy bought 10,000 shares of stock at \$10 per share in a pharmaceutical company. Today, the stock is worth \$200,000 and is paying a dividend of \$8,000 per year. Tom feels that the stock will continue to appreciate at a rate of 12% per year, including the dividend. Tom wants to establish a college education fund for his two daughters, ages 15 and 9. Which of the following statements is/are true?

1. If Tom gives 2,500 shares of stock to his 15-year-old daughter, all dividends from the 2,500 shares will be taxed in her income tax bracket.
 2. If Tom gives 2,500 shares of stock to his 9-year-old daughter, all dividends from the 2,500 shares will be taxed at her marginal rate.
 3. Two years from now, if Tom's older daughter sells her 2,500 shares of stock at \$30 per share, Tom will need to report the gain as a long-term capital gain on his personal income tax return.
 4. All dividend income earned by his 9-year-old daughter, which exceeds \$1,400 in 1998, will be taxed at Tom's marginal tax rate.
- A. 2 only.
 - B. 1 and 2 only.
 - C. 1 and 3 only.
 - D. 1 and 4 only.
 - E. 3 and 4 only.

77. A client asks you to explain the statement, "Life insurance proceeds are tax-free." You answer that the general rule(s), subject to some exceptions, is/are that death benefits received from a life insurance policy due to the death of the insured are income-tax-free to the beneficiary, but
1. Are subject to estate taxes in the estate of the insured if the insured owned the policy.
 2. May be subject to income taxes if the policy was sold to a third party.
 3. Not if the contract was modified at purchase.
- A. 1 only.
 - B. 2 only.
 - C. 1 and 2 only.
 - D. 2 and 3 only.
 - E. 1, 2, and 3.

Directions: This part consists of matching sets. Each matching set consists of a list of response options followed by a set of items. Follow the instructions that accompany each set to match the most appropriate response option to each item in the set. A response option may be used once, more than once, or not at all, unless otherwise specified.

- I. You are faced with the following alternative fixed income investments.
- A. A U.S. Treasury bond with an 11.625% coupon, due in 2004 with a price of \$142.50 and a yield to maturity of 6.3%.
 - B. A U.S. Treasury strip bond (zero coupon) due in 2004 with a price of \$46.75 and a yield to maturity of 6.25%.
 - C. A corporate B-rated bond with a 9.75% coupon, due in 2004 with a price of \$104.75 and a yield to maturity of 8.79%.

- _____ 78. Which of these bonds has the greatest reinvestment rate risk?
- _____ 79. Which of these bonds has the greatest interest rate risk?
- _____ 80. Which of these bonds has the longest duration?

- II. Match the charitable trust listed below with the corresponding descriptions in each of the items that follow.

- A. Charitable remainder annuity trust (CRAT).
- B. Charitable remainder unitrust (CRUT).
- C. Both A and B.
- D. Neither A nor B.

- _____ 81. Income tax advantage, life income.
- _____ 82. Estate tax advantage, income from the trust is variable.
- _____ 83. Income tax advantage, income from the trust is a sum certain.
- _____ 84. Estate tax advantage, immediate income to charity.

III. Investment A costs \$10,000,000 and offers a single cash inflow of \$13,000,000 after 1 year. Investment B costs \$1,000,000 and will be worth \$2,000,000 at the end of the year. The appropriate discount rate or required rate of return is 10% compounded annually. Match the investment(s) listed below with the corresponding financial information in the items that follow.

- A. Investment A.
- B. Investment B.
- C. Both A and B.
- D. Neither A nor B.

____ 85. The net present value (NPV) is \$818,182 and the internal rate of return is 30%.

____ 86. The NPV is \$818,182 and the internal rate of return is 100%.

____ 87. The NPV is \$1,818,182 and the internal rate of return is 30%.

IV. Match the investment characteristics listed below with the appropriate type of investment company in the items that follow.

- A. Passive management of the portfolios.
- B. Shares of the fund are normally traded in major secondary markets.
- C. Both A and B.
- D. Neither A nor B.

____ 88. Closed-end investment companies.

____ 89. Open-end investment company.

____ 90. Unit investment trust.

**CFP® Certification Examination Questions
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Multiple-Choice Questions

Directions: This part consists of multiple-choice questions. Each question or incomplete statement is followed by four suggested answers or completions. Select one best answer or completion for each question.

1. Which of the following best describes the difference between a variable life policy and a universal life policy?
 - A. Variable life has a variable death benefit and universal life has a fixed death benefit.
 - B. Variable life subaccounts do not guarantee market returns while the universal life contracts contain a guaranteed rate.
 - C. Universal life has guaranteed mortality charges while variable life has nonguaranteed mortality charges.
 - D. Variable life contracts do not guarantee market returns, while the market interest rates in universal life contracts are guaranteed.

2. A couple wants to accumulate a retirement fund of \$300,000 in current dollars in 18 years. They expect inflation to be 4% per year during that period. If they set aside \$20,000 at the end of each year and earn 6% on their investment, will they reach their goal?
 - A. Yes, they will accumulate \$10,368 more than needed.
 - B. Yes, they will accumulate \$47,454 more than needed.
 - C. No, they will accumulate \$10,368 less than needed.
 - D. No, they will accumulate \$47,454 less than needed.

3. The federal funds rate will tend to move upward under which of the following conditions?
 - A. The Federal Reserve is buying government securities.
 - B. The Federal Reserve lowers the discount rate.
 - C. A few banks have reserve deficiencies, and the rest have ample excess reserves.
 - D. A few banks have excess reserves, and the rest have significant reserve deficiencies.

"2004 Released Case Scenario and Multiple-Choice Questions"
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4. Which of the following is the correct justification for use of an investment in a client's portfolio?
- A. FNMA securities because they are backed by the full faith and credit of the U.S. government.
 - B. Call option purchases because they are a low-cost method of hedging a portfolio.
 - C. Blue chip common stocks because they provide a hedge against inflation.
 - D. Aggressive growth stocks because they perform better during economic contractions.
5. The Zeta Corporation's current dividend is \$3.85. If future dividends are expected to grow at 4% forever, which of the following amounts should Zeta stock sell for if the required rate of return on the stock is 14%?
- A. \$28.57.
 - B. \$38.50.
 - C. \$40.04.
 - D. \$41.60.
6. A corporate client has two principals, ages 57 and 61, with annual compensations of \$145,000 each. They employ a staff of nine, ages 21 to 40, with annual compensations of \$14,000 to \$50,000. The client wants a qualified plan that offers maximum benefits for the principals, minimum benefits for the nonprincipals, contribution flexibility and low administrative cost. Which of the following retirement plans should a CFP® certificant recommend?
- A. Defined benefit.
 - B. Profit sharing.
 - C. Simplified employee pension (SEP).
 - D. Age-weighted profit sharing.
7. Michelle purchased a \$100,000 life insurance policy on her life. To date, she has paid \$50,000 in total premiums and received \$10,000 in dividends. The policy currently has a net cash value of \$15,000 and is subject to a \$30,000 outstanding loan. If Michelle decides to surrender the policy, she would realize a gain of:
- A. \$0.
 - B. \$5,000.
 - C. \$10,000.
 - D. \$15,000.

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8. Which of the following statements concerning educational tax credits and savings opportunities is correct?
- A. The Lifetime Learning Credit is equal to 100% of qualified educational expenses up to a certain limit.
 - B. The HOPE credit is available for the first 4 years of postsecondary education.
 - C. A parent who claims a child as a dependent is entitled to take the HOPE credit for the educational expenses of the child.
 - D. The contribution limit for Coverdell Education Savings Accounts is applied per year per donor.
9. Treasury zero-coupon bonds are particularly suited to which of the following types of accounts?
- A. IRA.
 - B. Trust.
 - C. Corporate.
 - D. Joint.
10. Veronica recently purchased a car for \$1,500 for her 16-year-old child. Which of the following risk management techniques would be most appropriate for handling the collision exposure of this automobile?
- A. Subrogation.
 - B. Insurance.
 - C. Retention.
 - D. Avoidance.

11. Jim, recently retired, is 62 years old and expects to be in the maximum federal and state tax bracket. He plans to liquidate three of the investments listed below. Assume that each investment is worth \$50,000 and has grown from an original investment of \$25,000 over a period of more than 3 years. Liquidation of which three of the following investments, in order of priority, would result in the lowest tax liability for Jim?
1. 401(k) plan.
 2. CD paying 4%.
 3. U.S. savings bonds.
 4. Traditional IRA (contributions were not deductible).
 5. A blue chip stock.
- A. 2, 3 and 1.
 - B. 2, 5 and 3.
 - C. 2, 5 and 4.
 - D. 3, 5 and 1.
12. Simon is about to change jobs and plans to roll over the vested portion of his pension plan into either an IRA or the qualified retirement plan of his new employer. Reasons why a direct rollover into the new plan would be more appropriate include which of the following?
1. The new employer's plan is the only way Simon can get a distribution at retirement in the form of a life annuity.
 2. The new employer's plan contains a provision for loans.
 3. There is no tax penalty if a lump-sum benefit is withdrawn at early retirement after attaining age 55.
 4. Lump-sum withdrawals from the new employer's plan after age 59½ will be eligible for 5-year forward averaging.
- A. 1 only.
 - B. 1 and 3 only.
 - C. 2 and 3 only.
 - D. 2 and 4 only.

13. An individual received a bequest of 100 shares of XYZ stock from a relative who died on March 1 of this year. The relative bought the stock at a total cost of \$5,500. The value of the 100 shares of XYZ stock was \$5,750 on March 1. Its value rose to \$6,250 on July 1 of this year, on which day the individual sold it for \$6,250, incurring expenses for the sale of \$250. The taxable gain on the sale would be a:
- A. \$250 long-term capital gain.
 - B. \$250 short-term capital gain.
 - C. \$500 long-term capital gain.
 - D. \$500 short-term capital gain.
14. Ronald has established a trust that pays out \$1,000 each month to his mother, Martha. The trust department of Actual Bank acts as trustee. Ronald retains the right to revoke the trust and is the sole heir of his mother's estate and the remainder beneficiary of the trust. Which of the following must pay the income tax on the \$15,000 earned by the trust?
- A. Ronald pays on \$15,000.
 - B. Martha pays on \$12,000; the trust on \$3,000.
 - C. Martha pays on \$12,000; Ronald on \$3,000.
 - D. The trust pays on \$15,000.
15. Jorge is single and owns \$30,000 of stock he originally purchased 4 years ago for \$7,000. His adjusted gross income (AGI) is \$40,000. If Jorge donates the stock to his church, which of the following is the maximum amount he can deduct as a charitable contribution for this gift on his federal income tax return this year?
- A. \$12,000.
 - B. \$15,000.
 - C. \$20,000.
 - D. \$30,000.

16. Terry and Pat, 50/50 unrelated co-owners, set up a stock redemption agreement for their business. The value of their business is \$500,000, and they will fund their agreement with life insurance. They have asked a CFP® professional to advise them on the amount of insurance they should apply for on each life, who should be the owner, and who should pay for the life insurance contracts. Which of the following should the CFP professional recommend?
- A. The company should own and pay for two \$250,000 contracts, one on Terry and one on Pat.
 - B. Terry and Pat should each own a \$250,000 contract on the other. The company should pay the premiums on the contracts.
 - C. The company should own a \$500,000 contract on both Terry and Pat. The company should pay premiums on the contract.
 - D. Terry and Pat should each own a \$250,000 contract on the other and should individually pay the premium on the policy each owns.
17. Which of the following statements regarding alternative minimum tax (AMT) are true?
- 1. AMT reduces the tax benefits from certain types of deductions and tax preferences allowable for regular tax purposes.
 - 2. Depreciation allowable for AMT can never be the same as that allowable for regular tax purposes.
 - 3. It is generally advantageous to accelerate ordinary income into years when AMT will be paid.
 - 4. It is generally advantageous to defer to a future year the payment of state income and real estate taxes when AMT will be paid in the current year.
- A. 1 and 3 only.
 - B. 3 and 4 only.
 - C. 1, 2 and 4 only.
 - D. 1, 3 and 4 only.

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18. Advantages for incorporating a small retail business as a C corporation include which of the following?
1. Accumulating income at lower tax rates on the first \$75,000
 2. Withdrawing accumulated profits at capital gain rates
 3. Providing tax-favored fringe benefits to shareholders
 4. Changing the form of business with ease once a corporation has been formed
- A. 2 only.
B. 3 only.
C. 1 and 3 only.
D. 1 and 4 only.
19. A client currently is being audited by the IRS, and the agent has proposed a tax deficiency with which the client does not agree. The client has asked a CFP® certificant to research the issue. Which of the following sources is considered to be the most authoritative and, accordingly, would have the highest precedential value in defending the CFP certificant's position to the IRS?
- A. Revenue ruling.
B. Revenue procedure.
C. Private letter ruling.
D. Treasury regulations.
20. A client earns \$75,000 as a full-time employee of State University and also earns \$100,000 as an independent contractor (consultant) for several local area businesses. The client is covered under the university's 403(b) plan and makes the maximum salary reduction permissible. If the client would like to shelter from taxation as much consulting income as possible, which of the following would be the most appropriate?
- A. Making annual deductible contributions to a SIMPLE IRA.
B. Making the maximum possible contributions permitted each year to a SEP/IRA for the consulting business.
C. Investing up to 20% of the consulting income in tax-free municipal bonds.
D. Contributing the maximum allowable amount to a Section 457 plan.

21. Marcus has a salary of \$150,000. He contributes the maximum to his 401(k) and wishes to make the highest possible level of additional tax-deferred savings for retirement. Which of the following are feasible options for Marcus?
1. Invest in a flexible premium, deferred annuity.
 2. Make annual contributions to an IRA on a pretax basis.
 3. Make annual contributions to an IRA on an after-tax basis.
- A. 1 only.
 - B. 3 only.
 - C. 1 and 2 only.
 - D. 1 and 3 only.
22. Henry, an employee of Acme Inc., was granted 1,000 incentive stock options (ISO) with a strike price of \$30, and 2,500 nonqualified stock options (NSO) with a strike price of \$45. Acme Inc. traded for \$80 per share on the day Henry exercised 500 ISOs and 1,000 NSOs and held the shares in his portfolio. Which of the following statements is true regarding Henry's current income tax situation resulting from the exercise of his stock options?
- A. The resulting ordinary income of \$60,000 is subject to payroll taxes only.
 - B. The resulting ordinary income of \$35,000 is subject to payroll taxes and an alternative minimum tax (AMT) preference of \$25,000.
 - C. The resulting ordinary income of \$125,000 is subject to payroll taxes and an alternative minimum tax (AMT) preference of \$80,000.
 - D. The resulting ordinary income of \$25,000 is subject to payroll taxes and the remaining ordinary income of \$35,000 is not subject to payroll taxes.
23. A client has a growth objective but requires a large percentage of the return to be tax efficient. Which of the following products would be most appropriate for this client?
- A. Nonleveraged equipment leasing.
 - B. Balanced mutual fund.
 - C. Preferred stock mutual fund.
 - D. Stock index fund.

Problem Set

Directions: This part consists of a problem set, defined as a brief fact pattern followed by two or more questions or incomplete statements. Each question or incomplete statement is followed by four suggested answers or completions. Select one best answer or completion for each question. Each question should be answered independently.

I. James and Susan Hansen, a happily married couple, live in a common-law state. James has asked for help with estate planning. Soon after their marriage, they executed simple Wills to name guardians for their children and to leave all assets to each other in the event of death.

James wants to be sure that they have enough money for retirement. He does not want to “spoil” his children by giving them too much money, and he wants to pay as little as possible in taxes. Susan wants to make life easier for their three children by making generous gifts of assets to them. She would also like to make major gifts to her church and a favorite charity. James hesitantly agrees to start contributing some family assets to charity.

James: age 55, business executive, \$120,000 annual salary

Susan: age 53, homemaker

David: age 30, a physician, divorced, 2 children (ages 3 and 2)

Kristin: age 27, computer programmer, widowed, 1 child (age 1)

Todd: age 18, college freshman, \$20,000 tuition per year, single

Federal income tax bracket is 28%.

No inheritances are anticipated.

<u>Asset</u>	<u>Value</u>	<u>Related Liability</u>	<u>Monthly Investment</u>	<u>Estimated Annual Total Return</u>	<u>Ownership</u>	<u>Income Tax Basis</u>
Checking	\$ 5,000				JTWROS	\$5,000
Savings	6,000			3%	JTWROS	\$6,000
Certificates of Deposit	380,000			5%	Susan	\$380,000
Home	280,000	\$50,000			JTWROS	\$130,000
Vehicles, furniture, etc.	90,000				JTWROS	
Stocks ¹	300,000		\$2,000	10%	James	\$100,000
Apartments (4-plex) ²	260,000	\$90,000		4%	JTWROS	\$125,000
401(k) ³	<u>600,000</u>		\$700	10%	James	
Total Assets	\$1,921,000					

<u>Life Insurance</u>	<u>Cash Value</u>	<u>Death Benefit</u>	<u>Insured</u>	<u>Owner</u>	<u>Beneficiary</u>
Group Term Life Insurance		\$120,000	James	James	Susan
Life Insurance ⁴	\$30,000	\$250,000	James	James	Susan
Life Insurance	\$5,000	\$50,000	Susan	Susan	James

¹ Purchased over a 20-year period.

² Cost of \$180,000 less straight-line depreciation of \$55,000.

³ All in equity mutual funds, Susan is the beneficiary.

⁴ A total of \$20,000 of premiums have been paid.

24. Which of the following recommendations would result in the most significant reduction of transfer taxes for the Hansens?
- A. Assign ownership of James \$250,000 life insurance policy to Susan.
 - B. Equalize their estates by changing ownership of each separately owned asset to joint tenancy with right of survivorship (JTWROS).
 - C. Establish and make regular gifts to custodial accounts for their children and grandchildren.
 - D. Establish revocable living trusts with by-pass provisions.
25. If James were to die today, the value of the assets included in his probate estate would be:
- A. \$300,000.
 - B. \$900,000.
 - C. \$1,270,000.
 - D. \$1,590,500.
26. If James were to die today, the amount of his gross estate would be:
- A. \$1,220,500.
 - B. \$1,520,500.
 - C. \$1,590,500.
 - D. \$1,911,000.
27. If the \$250,000 life insurance policy on James life is not needed to provide income for Susan upon his death, which of the following would be best from a tax perspective?
- A. Transfer the policy to an irrevocable life insurance trust with the children as trust beneficiaries.
 - B. Surrender the policy to receive the cash surrender value.
 - C. Assign ownership of the policy to Susan and name the children as beneficiaries of the policy.
 - D. Assign ownership of the policy to Susan and name James estate as beneficiary of the policy.

28. If Susan were to die today, which of the following amounts would be allowable as a marital deduction on her estate tax return?
- A. \$380,000.
 - B. \$430,000.
 - C. \$680,500.
 - D. \$750,500.