

CFP® CERTIFICATION EXAMINATION
2004 RELEASED CASE SCENARIO AND
MULTIPLE-CHOICE QUESTIONS

CERTIFIED FINANCIAL PLANNER

BOARD OF STANDARDS, INC.



CERTIFIED FINANCIAL PLANNER™



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CFP® Certification Examination

2004 Released Case Scenario and Multiple-Choice Questions

Introduction

The *CFP® Certification Examination 2004 Released Case Scenario and Multiple-Choice Questions* booklet is designed to familiarize testers with the format and cognitive level of questions on the CFP® Certification Examination. The released questions are intended to be a useful sampling that illustrates the degree of complexity and breadth of the exam. These questions do not represent an actual exam in length or topic coverage, so testers should not equate success or failure of these questions to success or failure on the CFP® Certification Examination.

Released in August 2004, the Davis case and its 12 related multiple-choice questions, as well as the 28 multiple-choice and mini-set questions have been previously used on CFP® Certification Examinations. These questions are updated to reflect current law and practice as of August 2004, but will not be further maintained to incorporate future changes in law and practice. The correct answer to each question is indicated with an asterisk.

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Case Problem with Multiple-Choice Questions

Directions: This part consists of one case problem followed by a set of 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.

SUSAN DAVIS

Susan Davis, a new client, has requested that a CFP® certificant assist her in evaluating her personal and business financial situation. Susan is the founder and sole stockholder of Exclusively Unique Gifts, Inc., a C corporation. Her children work part-time in the shop as permitted by state law. Susan is a recent divorcee and realizes that her finances may need to be revised now that her divorce has been settled. Her former husband, Richard, is the father of her two children and the major stockholder of Davis Manufacturing, Inc. Davis Manufacturing has been in business 15 years, is financially stable, and currently has a book value in excess of \$1,400,000.

Personal Information

<u>Name</u>	<u>Age</u>	<u>Health</u>	<u>Occupation</u>
Susan Davis	39	Good	President - Exclusively Unique Gifts, Inc.
Mary Beth Davis	14	Excellent	Student
Nathaniel Davis	9	Excellent	Student
Richard Davis	42	Excellent	President - Davis Manufacturing, Inc.

Wills were last completed 5 years ago. They live in a common-law state.

Economic Environment

Currently, the economy is in a recovery phase with decreasing unemployment and increasing economic growth. Inflation and interest rates are currently low. It currently costs \$12,000 per year to attend college, and this cost is expected to increase at 5% each year. Susan prefers to save monthly and can earn 9% (after taxes) on the college account.

Client Objectives

1. Ensure financial security for herself and her children by:
 - Planning for her portion of the 4-year funding for the children's college education
 - Retiring at age 55
 - Using direct deposit from her paycheck at the end of each month to fund education and retirement
2. Develop a plan that will provide for the care of her children without passing any of her assets to Richard.
3. Review all insurance coverages and make adjustments necessary to provide proper risk management.
4. Review and develop proper strategies for her business to provide both current and retirement income for herself. Susan tends to be conservative and prefers to assume only moderate risks. Safety of principal and risk diversification are primary concerns now that she is divorced. The reduction of taxes is of secondary importance.
5. Retain and reward current full-time employees of the business while maintaining cash flow flexibility.

SUSAN DAVIS
STATEMENT OF FINANCIAL POSITION
12/31 Prior Year

ASSETS		LIABILITIES	
<u>Invested Assets</u>		Credit cards ¹	\$ 6,000
Cash/Cash equivalents	\$ 2,000	Mortgage ²	60,000
Business interest	<u>286,000</u>	Auto loan	<u>3,000</u>
Total	<u>\$288,000</u>	TOTAL LIABILITIES	<u>\$ 69,000</u>
<u>Use Assets</u>			
Residence ^{3,4}	\$330,000		
Personal property	50,000		
Auto	<u>15,000</u>		
Total	<u>\$395,000</u>	NET WORTH	<u>\$638,000</u>
<u>Retirement Plan Assets</u>			
IRA (growth mutual funds)	<u>\$ 24,000</u>		
TOTAL ASSETS	<u>\$707,000</u>	TOTAL LIABILITIES AND NET WORTH	<u>\$707,000</u>

¹ Variable rate, currently 16.9% APR.

² Fixed rate of 9.5% in the name of Richard and Susan Davis; 4 years, 7 months are remaining on the loan.

³ Originally purchased 15 years, 5 months ago for \$110,000. Excellent condition with no major repairs foreseen in the near future.

⁴ Lot valued at \$50,000; dwelling valued at replacement cost, which is approximately the same as fair market value.

SUSAN DAVIS
PROJECTED MONTHLY CASH FLOW STATEMENT
Current Year

CASH INFLOWS

Gross salary	\$4,300
Child support	<u>1,400</u>
Total	<u>\$5,700</u>

CASH OUTFLOWS

Savings and investments	\$ 0
Mortgage (P & I)	1,350
Property taxes	300
Homeowners insurance	100
Insurance (other insurance)	50
Maintenance and repairs on the home	100
Food and supplies	500
Utilities	350
Transportation (gas, oil, repairs)	200
Car payment	150
Clothing	200
Travel and entertainment	250
Credit card payments	250
State and local income tax (flat 4%)	160
Federal income tax ¹	800
FICA	<u>300</u>
Total	<u>\$5,060</u>

SURPLUS/(DEFICIT) CASH FLOW \$ 640

¹ Susan is in the 25% federal marginal tax bracket.

SUSAN DAVIS
INSURANCE INFORMATION

Homeowners Policy

Type	HO-3 (open-peril)
Amount on dwelling	\$270,000
Personal property coverage	\$145,000
Personal liability	\$100,000

Automobile Policy

Type	Personal auto policy
Bodily injury/property damage	\$300,000 combined single limit
Collision	\$300 deductible
Comprehensive	\$250 deductible
Uninsured motorist	\$300,000 single limit

Employee Benefits Provided by Exclusively Unique Gifts, Inc.

Life insurance	Employee - two times earnings Dependents - \$2,000
Medical	\$300 deductible, 80/20 coinsurance Out-of-pocket maximum \$5,000 Lifetime limit \$500,000 Coverage on employees only
Disability	Company pays 50% of salary for 6 months Waiting period - 5 working days

EXCLUSIVELY UNIQUE GIFTS, INC.¹
YEAR-END BALANCE SHEET
12/31 Prior Year

ASSETS

Cash/Cash equivalents	\$ 33,000
Accounts receivable	110,000
Inventory	250,000
Furniture and fixtures, net of depreciation	127,000
Prepaid expenses & other	<u>44,000</u>

TOTAL ASSETS \$564,000

LIABILITIES

Accounts payable	\$128,000
Loan ²	<u>150,000</u>
TOTAL LIABILITIES	<u>\$278,000</u>

STOCKHOLDER EQUITY³ \$286,000

**TOTAL LIABILITIES AND
SHAREHOLDER EQUITY** \$564,000

¹ All assets are listed at fair market value (FMV)

² \$4,000 a month payable to Richard Davis at 10% interest, which is the going market rate on similar loans.

³ The company has experienced increasing profits over the last 7 years.

EXCLUSIVELY UNIQUE GIFTS, INC.
PROJECTED MONTHLY INCOME AND EXPENSES
 Current Year

TOTAL SALES¹	<u>\$125,000</u>
 EXPENSES	
Cost of goods sold	\$ 75,000
Advertising and promotion	1,500
Depreciation	2,400
Interest on loan	1,250
Insurance - business	250
Payroll taxes and benefits	3,400
Rent	4,700
Salaries ²	16,300
Supplies and miscellaneous	3,500
Utilities	1,200
Income taxes, fed and state (estimated)	<u>5,600</u>
 TOTAL EXPENSES	 \$115,100
 NET INCOME	 <u>\$ 9,900</u>

¹ Sales vary directly with the local economy and are projected to increase/decrease at twice the rate of change in the local economy. This year's sales and economic growth was estimated at 8%.

² Employee data:

<u>Name</u>	<u>Monthly Salary</u>	<u>Date of Hire</u>	<u>Age</u>	<u>Status</u>
Susan Davis	\$4,300	1/01/94	39	100% stockholder/full-time employee
Kate Jackson*	\$3,000	6/01/95	28	Full-time employee
Cindi Smith	\$2,500	2/15/97	47	Full-time employee
Sandy Wise	\$2,500	8/15/97	34	Full-time employee
Tom Mitcham	\$2,200	3/01/99	36	Full-time employee
Jack Young	\$500	7/15/01	20	Part-time employee less than 1,000 hours
Steve Jones	\$500	7/15/02	17	Part-time employee less than 1,000 hours
Sue Jackson	\$500	8/01/02	19	Part-time employee less than 1,000 hours
Amy DeLong	\$300	8/15/02	22	Part-time employee less than 1,000 hours
Mary Beth Davis	\$200	1/01/03	14	Part-time employee less than 1,000 hours
Nathaniel Davis	\$200	1/01/03	9	Part-time employee less than 1,000 hours

* Kate has expressed an interest in investing up to \$100,000 in the business at this time and would like to acquire 100% ownership should Susan ever decide to sell. If Kate did acquire partial ownership, she would become the corporate secretary and vice-president.

RICHARD AND SUSAN DAVIS

SUMMARY OF DIVORCE AGREEMENT, incorporated into the divorce decree
Prior Year

Custody	Joint, with the children residing primarily with their mother. Both children will reside with their father in the event of their mother's death.										
Tax Returns	Susan will claim the children as dependents.										
Child Support	Richard is to pay \$700 per month per child until each child reaches age 18.										
College Support	College costs are to be divided evenly in thirds, with $\frac{1}{3}$ being paid by Richard, $\frac{1}{3}$ by Susan, and $\frac{1}{3}$ by the student.										
Insurance	Richard is to provide adequate health insurance on the children until after their graduation from college and also \$10,000 of life insurance on each child. In addition, Richard must carry \$175,000 life insurance on himself with the children named as the beneficiaries until the younger child reaches age 23.										
Assets	Susan is granted 100% equity in both the residence and Exclusively Unique Gifts, Inc., while Richard receives all of the invested assets and also 100% equity in Davis Manufacturing, Inc. and his retirement plan. Susan is to refinance the mortgage on the personal residence to remove Richard's name as a debtor. Richard will continue to hold the business loan for Exclusively Unique Gifts, Inc., provided that no additional loans are acquired.										
Alimony	Five-year payment schedule to Susan from Richard: <table><tr><td>Year 1</td><td>\$10,000</td></tr><tr><td>Year 2</td><td>\$30,000</td></tr><tr><td>Year 3</td><td>\$15,000</td></tr><tr><td>Year 4</td><td>\$15,000</td></tr><tr><td>Year 5</td><td>\$15,000</td></tr></table>	Year 1	\$10,000	Year 2	\$30,000	Year 3	\$15,000	Year 4	\$15,000	Year 5	\$15,000
Year 1	\$10,000										
Year 2	\$30,000										
Year 3	\$15,000										
Year 4	\$15,000										
Year 5	\$15,000										

1. Which of the following is the most appropriate strategy to improve Susan's financial security?
 - A. Establish and borrow on a home equity line of credit.
 - B. Sell her current residence, buy a less expensive home, and invest the net proceeds in municipal bonds.
 - C. Increase her salary for personal debt reduction and investments.
 - D. Sell 50% of the business to Kate for \$100,000 in cash.

2. Which of the following statements regarding Susan's insurance coverages is correct?
 - (1) The disability insurance on Susan is adequate.
 - (2) The property section of her homeowners insurance is adequate at the present levels of coverage.
 - (3) Susan's personal liability coverage is adequate.
 - (4) Susan needs additional life insurance.
 - (5) The medical insurance is inadequate since Susan does not have dependent coverage on her policy.
 - A. (2) and (4) only
 - B. (1), (2), and (3) only
 - C. (2), (3), and (4) only
 - D. (3), (4), and (5) only

3. Susan wants to start investing \$600 monthly to achieve her stated objectives. Which of the following monthly investments is most appropriate for Susan at this time?
 - A. \$200 in a money market account, \$200 in a Roth IRA account funded with short-term Treasury bills, and \$200 in a Roth IRA international growth fund
 - B. \$500 in a growth mutual fund and \$100 in a municipal bond fund
 - C. \$100 in a money market account and \$500 in a long-term U.S. Government bond fund
 - D. \$100 in a money market account, \$150 in a Roth IRA global balanced mutual fund, and \$350 in a short-term bond fund

4. Which of the following statements about investment risks is true?
 - A. Susan's investment liquidity is appropriate for her goals.
 - B. Susan's current investments are subject to unsystematic risk.
 - C. Richard's risk exposure would benefit from having the business loan paid off early if interest rates decrease.
 - D. Susan will reduce her interest rate exposure if she refinances her home with a 30-year, 9.5% fixed-rate mortgage.

5. Susan has asked the CFP[®] certificant to recommend an employee benefit plan to fulfill her objectives. Which of the following types of plans would be most appropriate?
 - A. SIMPLE IRA
 - B. Simplified employee pension (SEP)
 - C. Profit sharing
 - D. Target benefit

6. Susan has decided to improve the benefits provided to all full-time employees of Exclusively Unique Gifts, Inc. Due to financial constraints, she can implement only three of the following options over the next 3 years. Which three of the following options should the CFP[®] certificant recommend as the most beneficial?
 - (1) Increasing the life insurance to a maximum of five times earnings
 - (2) Decreasing the medical out-of-pocket maximum to \$2,500
 - (3) Increasing the medical insurance lifetime limit to \$1,000,000
 - (4) Increasing the disability benefit to 70% of salary for 6 months
 - (5) Providing long-term disability coverage equal to 50% of earnings
 - A. (1), (2), and (5)
 - B. (2), (3), and (4)
 - C. (2), (3), and (5)
 - D. (3), (4), and (5)

7. If Susan decides to move into a less expensive home and has approximately \$200,000 to invest from the sale proceeds of her home, which of the following portfolios would be most appropriate for her, given her goals and current investments?
- \$50,000 certificate of deposit, \$50,000 money market account, and \$100,000 Treasury bill
 - \$50,000 money market account, \$50,000 Standard & Poor's 500 (S&P 500) index fund, and \$100,000 balanced mutual fund
 - \$120,000 aggressive-growth stock fund and \$80,000 U.S. Government long-term bond fund
 - \$150,000 growth mutual fund and \$50,000 Standard & Poor's 500 (S&P 500) index mutual fund
8. Which of the following actions would be most appropriate for Susan to take now to plan for her estate liquidity?
- Purchase a life insurance policy
 - Establish an unfunded IRC Section 303 corporate stock redemption plan
 - Arrange for a 10-year installment sale of the business to Kate
 - Use a grantor retained income trust (GRIT) to remove assets from the taxable estate
9. Susan's company adopts a profit sharing plan for the company with the following characteristics: the plan requires 1 year of service and attainment of age 21 and, in practice, is not top heavy. True statements about the plan include which of the following?
- Both Susan and Kate would be classified as highly compensated employees.
 - The plan would meet the minimum eligibility requirements.
 - This year, all part-time employees would be excluded.
 - A 7-year, graded vesting schedule would best fulfill Susan's objectives.
- (4) only
 - (2) and (3) only
 - (1), (2), and (4) only
 - (2), (3), and (4) only
10. True statements regarding Susan and Richard's 5-year alimony payment schedule include which of the following?
- To qualify as alimony, payments must be made as part of a written divorce agreement, signed by Susan and Richard.
 - To qualify as alimony for income tax purposes, payments must be in cash, the couple must live in separate households, and payments must cease upon Susan's death.
 - The alimony payment schedule constitutes excess alimony.
- (1) only
 - (3) only
 - (1) and (2) only
 - (2) and (3) only
11. Susan wants to establish a trust to provide for her children in case of her death. Which of the following should the CFP® certificant recommend as the most appropriate trust given Susan's overall situation and objectives?
- An irrevocable life insurance trust granting Crummey powers to the children
 - A grantor retained income trust (GRIT) with Mary Beth and Nathaniel named as beneficiaries
 - A revocable living trust naming a third party as successor trustee, with Susan as the primary beneficiary while living and the children listed as contingent beneficiaries
 - A revocable living trust naming the children as beneficiaries and Richard as the trustee
12. If Susan sells her current residence for \$367,000 and she purchases a new residence for \$180,000 in the same calendar year, the amount of proceeds subject to capital gains tax is
- \$0
 - \$7,000
 - \$187,000
 - \$257,000

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.

13. 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 sub-accounts 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 non-guaranteed mortality charges.
 - D. Variable life contracts do not guarantee market returns, while the market interest rates in universal life contracts are guaranteed.
14. 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.
15. 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.
16. 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
17. 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
18. 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 non-principals, 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

19. 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
- \$0
 - \$5,000
 - \$10,000
 - \$15,000
20. Which of the following statements concerning educational tax credits and savings opportunities is correct?
- The lifetime learning credit is equal to 100% of qualified educational expenses up to a certain limit.
 - The Hope credit is available for the first 4 years of postsecondary education.
 - A parent who claims a child as a dependent is entitled to take the Hope credit for the educational expenses of the child.
 - The contribution limit for Coverdell Education Savings Accounts is applied per year per donor.
21. Treasury zero coupon bonds are particularly suited to which of the following types of accounts?
- IRA
 - Trust
 - Corporate
 - Joint
22. 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?
- Subrogation
 - Insurance
 - Retention
 - Avoidance
23. 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?
- 401(k) plan
 - CD paying 4%
 - U.S. savings bonds
 - Traditional IRA (contributions were not deductible)
 - A blue chip stock
- (2), (3), (1)
 - (2), (5), (3)
 - (2), (5), (4)
 - (3), (5), (1)
24. 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?
- The new employer's plan is the only way Simon can get a distribution at retirement in the form of a life annuity.
 - The new employer's plan contains a provision for loans.
 - There is no tax penalty if a lump-sum benefit is withdrawn at early retirement after attaining age 55.
 - Lump-sum withdrawals from the new employer's plan after age 59½ will be eligible for 5-year forward-averaging.
- (1) only
 - (1) and (3) only
 - (2) and (3) only
 - (2) and (4) only

25. 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
- \$250 long-term capital gain
 - \$250 short-term capital gain
 - \$500 long-term capital gain
 - \$500 short-term capital gain
26. 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?
- Ronald pays on \$15,000.
 - Martha pays on \$12,000; the trust on \$3,000.
 - Martha pays on \$12,000; Ronald on \$3,000.
 - The trust pays on \$15,000.
27. 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?
- \$12,000
 - \$15,000
 - \$20,000
 - \$30,000
28. 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?
- The company should own and pay for two \$250,000 contracts, one on Terry and one on Pat.
 - Terry and Pat should each own a \$250,000 contract on the other. The company should pay the premiums on the contracts.
 - The company should own a \$500,000 contract on both Terry and Pat. The company should pay premiums on the contract.
 - Terry and Pat should each own a \$250,000 contract on the other and should individually pay the premium on the policy each owns.
29. Which of the following statements regarding alternative minimum tax (AMT) are true?
- AMT reduces the tax benefits from certain types of deductions and tax preferences allowable for regular tax purposes.
 - Depreciation allowable for AMT can never be the same as that allowable for regular tax purposes.
 - It is generally advantageous to accelerate ordinary income into years when AMT will be paid.
 - 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.
- (1) and (3) only
 - (3) and (4) only
 - (1), (2), and (4) only
 - (1), (3), and (4) only

30. 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
31. 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
32. 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
33. 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 pre-tax 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
34. Henry, an employee of Acme Inc., was granted 1,000 incentive stock options (ISO) with a strike price of \$30, and 2,500 non-qualified 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.
35. 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. Non-leveraged 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

36. Which of the following recommendations would result in the most significant reduction of transfer taxes for the Hansens?
- A. Assign ownership of James's \$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.
37. 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
38. 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
39. If the \$250,000 life insurance policy on James's 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's estate as beneficiary of the policy.
40. 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

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