1994 and 1996 CFP® Certification Examination Questions

Introduction

The *1994 and 1996 CFP® Certification Examination 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 format, the degree of complexity and breadth of the exam. These questions do not represent an actual exam in length or topic coverage. The content of these questions has not been updated and should not be used as study materials or aids. Testers should not equate success or failure of these questions to success or failure on the CFP® Certification Examination.

The correct answer to each question is indicated with an asterisk. However, changes for current law and practice subsequent to the use of the questions on the CFP® Certification Examination are not considered as of the date of release. The questions that are no longer correct due to law changes are left unedited. These questions were used previously on the CFP® Certification Examination when the law correctly applied.

CFP Certification Examination Questions Released as of December, 1996

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

(Released December 1996.)

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 .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

(Released December 1996.)

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

(Released December 1996.)

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

(Released December 1996.)

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.

(Released December 1996.)

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.

Below is the CFP Board of Examiner’s response to a candidate’s question regarding this exam item.
Note that while the conditional receipt sets forth certain terms of temporary life insurance coverage, it will not be issued without a completed application and payment of an initial premium.

(Released December 1996.)
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

(Released December 1996.)
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

(Released December 1996.)
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

(Released December 1996.)
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

(Released December 1996.)
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

(Released December 1996.)
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.

(Released December 1996.)

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

(Released December 1996.)

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 which 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.

(Released December 1996.)

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.

(Released December 1996.)

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.

<u>Parcel A</u>: 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.

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

(Released December 1996.)

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

(Released December 1996.)
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.

(Released December 1996.)
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

(Released December 1996.)
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

(Released December 1996.)
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).

(Released December 1996.)
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.

(Released December 1996.)

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

(Released December 1996.)

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.

(Released December 1996.)

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)

(Released December 1996.)

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

(Released December 1996.)
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

(Released December 1996.)
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

(Released December 1996.)
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

(Released December 1996.)
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

(Released December 1996.)
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.

(Released December 1996.)
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.

(Released December 1996.)

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.

(Released December 1996.)

33. 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 <u>no</u> capital gains distributions.

During the 12 months from June 30, last year, through June 30, 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%.

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

(Released December 1996.)
34. 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 which 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) only
C. (2) and (4) only
* D. (2) and (5) only
E. (1), (3) and (5) only

(Released December 1996.)
35. 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) only
B. (1) and (2) only
* C. (2) and (4) only
D. (4) only
E. (1), (2), (3) and (4)

(Released December 1996.)
36. 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) only
B. (2) and (4) only
* C. (1) and (4) only
D. (1), (2), (3) and (4)
E. (2), (3) and (4) only

(Released December 1996.)
37. 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 <u>not</u> intended to directly benefit the employer.
(4) <u>not</u> acceptable, since the employer is considered a party-in-interest.

A. (2) only
* B. (4) only
C. (2) and (3) only
D. (1), (2) and (3) only

(Released December 1996.)
38. 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) only
* B. (1) and (2) only
C. (2) and (3) only
D. (3) and (4) only
E. (2) and (4) only

(Released December 1996.)
39. 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) only
B. (3) only
C. (2) and (4) only
D. (1), (2) and (4) only
* E. (1), (2), (3) and (4)

(Released December 1996.)
40. 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) only
B. (1) and (4) only
C. (1), (2) and (4) only
D. (3) only
* E. (1), (2), (3) and (4)

(Released December 1996.)
41. 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) only
* B. (1) only
C. (2) and (3) only
D. (2) only
E. (1) and (2) only

(Released December 1996.)
42. 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 which must meet this requirement.

(1) profit-sharing plan
(2) money purchase plan
(3) target benefit plan
(4) defined benefit plan

A. (1) and (2) only
B. (2) and (3) only
C. (1) only
D. (3) and (4) only
* E. (4) only

(Released December 1996.)
43. 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) only
* B. (1), (3) and (4) only
C. (2) and (5) only
D. (2), (3) and (4) only
E. (2) and (5) only

(Released December 1996.)
44. 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) only
B. (1) and (3) only
C. (2) and (4) only
D. (3) and (4) only
* E. (1), (2) and (4) only

(Released December 1996.)

45. 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) only
B. (1) and (3) only
C. (2) and (4) only
D. (4) only
E. (1), (2), (3) and (4)

(Released December 1996.)

46. 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) only
B. (1) and (3) only
C. (2) and (4) only
D. (4) only
* E. (1), (2), (3) and (4)

(Released December 1996.)

47. 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) only
B. (2) and (4) only
C. (1), (3) and (4) only
* D. (1) and (3) only
E. (2) only

(Released December 1996.)

48. 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) only
B. (1) and (4) only
* C. (2), (3) and (4) only
D. (2) only
E. (4) only

(Released December 1996.)

49. 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) only
B. (1) and (2) only
* C. (2) and (4) only
D. (4) only
E. (1), (2), (3) and (4)

(Released December 1996.)

50. 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 which 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) only
B. (1) and (4) only
C. (1), (2) and (5) only
D. (3), (4) and (5) only
* E. (2), (3) and (5) only

(Released December 1996.)

51. 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 <u>not</u> be included in the decedent's gross estate.
(3) Property that passes by operation of law <u>cannot</u> 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) only
* C. (1) and (4) only
D. (1), (3) and (4) only
E. (2) and (3) only

(Released December 1996.)

52. 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) only
* B. (1) and (3) only
C. (2) and (3) only
D. (2) and (4) only
E. (1), (2), (3) and (4)

58.

(Released December 1996.)
53. 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) only
B. (2), (3) and (4) only
C. (1) and (4) only
D. (1), (3) and (4) only
* E. (3) only

(Released December 1996.)
54. 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) only
E. (2) and (3) only

(Released December 1996.)
55. 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) only
B. (1), (2) and (3) only
C. (1), (2), (3) and (4)
D. (2) and (3) only
E. (4) only

(Released December 1996.)
56. 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) only
B. (1) and (2) only
C. (1) and (4) only
D. (2) and (3) only
E. (2) and (5) only

59.

(Released December 1996.)
57. 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 which 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) only
B. (1) and (3) only
C. (2) and (4) only
* D. (4) only
E. (1), (2), (3) and (4)

(Released December 1996.)
58. 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) only
B. (1), (2) and (4) only
* C. (1), (2) and (3) only
D. (4) only
E. (1), (2), (3) and (4)

(Released December 1996.)
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) only
B. (1) and (4) only
* C. (3) and (5) only
D. (4) only
E. (2), (3) and (4) only

60. 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.

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) only
* D. (1) and (2) only
E. (1), (2) and (3)

(Released December 1996.)

61. 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) only
B. (1) and (3) only
C. (2) and (4) only
* D. (3) only
E. (1), (2), (3) and (4)

(Released December 1996.)

62. 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) only
B. (1), (3) and (4) only
C. (2) and (3) only
D. (2) and (4) only
* E. (2) only

(Released December 1996.)

63. 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 which 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 <u>not</u> 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) only
C. (1) and (4) only
D. (4) only
* E. (2) only

(Released December 1996.)
64. 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 59_, 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 59_.
(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) only
E. (1) and (4) only

(Released December 1996.)
65. 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) only
B. (1) and (3) only
C. (2) and (4) only
D. (4) only
* E. (1), (2), (3) and (4)

(Released December 1996.)
66. 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) only
B. (2) and (4) only
C. (3) only
D. (1) and (4) only
E. (2) and (3) only

(Released December 1996.)
67. 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) only
B. (2) and (4) only
C. (1) only
D. (3), (4) and (5) only
* E. (1), (2), (3) and (4) only

Item Sets

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.

(Released December 1996.)

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.

68. 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) only
B. (3) and (5) only
C. (1), (2) and (4) only
D. (3) only
* E. none of the above

69. 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) only
* B. (1), (2) and (4) only
C. (3) and (4) only
D. (1) and (2) only

(Released December 1996.)

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.

70. 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) only
B. (1), (2) and (3) only
* C. (2) and (4) only
D. (2), (3) and (4) only
E. (3) and (4) only

(Released December 1996.)

71. 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 which 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) only
* B. (1) and (3) only
C. (2) only
D. (3) only
E. (1) only

(Released December 1996.)

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."

72. 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.

73. 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.

(Released December 1996.)

IV. Smith invests in a limited partnership which 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.

YEARS	CASH FLOWS	
0	($9,200)	CFo
1	$600	CF1
2	$2,300	CF2
3	$2,200	CF3
4	$6,800	CF4
5	$9,500	CF5

74. The after-tax IRR of this investment is

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

75. 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) only
B. (2) and (3) only
C. (1) only
* D. (1), (2) and (3) only
E. (1) and (4) only

(Released December 1996.)

V. 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 JoAnn's behalf is $4,000.

76. 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

77. 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

(Released December 1996.)

VI. 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.

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

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

79. The adjusted taxable gifts will be

A. zero.
* B. $30,000.
C. $40,000.
D. $370,000.

80. 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

(Released December 1996.)

VII. John Rivera owns a $300,000 level-term life policy which 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 which 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.

81. 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 <u>no</u> taxable gain.
D. John would have a taxable gain only if he died while the insurance was in force.

82. 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.

CFP Certification Examination Questions Released as of November, 1994

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

(question released November, 1994)
1. 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

(question released November, 1994)
2. 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 3_ 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

(question released November, 1994)
3. 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.

(question released November, 1994)
4. 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

(question released November, 1994)
5. Arrange the following financial planning functions into the logical order in which these functions are performed by a professional financial planner.

(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)

(question released November, 1994)

6. Which one of the following statements is <u>not</u> 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 <u>nor</u> retained earnings are required in order to make contributions.

(question released November, 1994)

7. 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 <u>no</u> 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 <u>no</u> 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 <u>cannot</u> be determined unless one knows whether a QTIP election was made.

(question released November, 1994)

8. 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)

(question released November, 1994)

9. Which of the following is <u>not</u> 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

(question released November, 1994)

10. 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

(question released November, 1994)

11. Conditions that increase either the frequency or severity of loss are called

- A. subrogation.
- B. risks.
- * C. hazards.
- D. perils.
- E. extenuating circumstances.

(question released November, 1994)

12. 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 3_% 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

(question released November, 1994)
13. 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

Below is the CFP Board of Examiner’s response to a candidate’s question regarding this exam item.
70% of the preferred dividends received by a corporation are exempt from federal income taxes. (Actually, if 20% or more of the corporation paying the dividend is owned by the company receiving the dividends, then up to 100% of the dividend is tax free.
E. non-profit institutional--Typically pay no fed. taxes therefore, the corporate dividend received deduction of 70% is of no value.

(question released November, 1994)
14. Which one of the following statements is <u>not</u> 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

(question released November, 1994)
15. An HO-3 policy (Special form-"All risks of physical loss" except those specifically excluded) with <u>no</u> endorsements excludes which one of the following perils?

* A. flood
B. fire
C. collapse
D. weight of ice
E. volcanic eruption

(question released November, 1994)
16. 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.

(question released November, 1994)

17. A call option with a strike price of 110 is selling for 3_ when the market price of the underlying stock is 108. The intrinsic value of the call is

* A. 0
B. 1_
C. 2
D. 3_
E. -2

Below is the CFP Board of Examiner's response to a candidate's question regarding this exam item.
This is a good question because it is commonly misunderstood. Intrinsic value reflects the amount, if any, by which an option is "in the money". It can not be less than "0". "In the money"=market price--exercise price. Do you find yourself reversing formula components (which, by the way, is exactly why distractor C was offered)?

(question released November, 1994)

18. 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 <u>not</u> 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 <u>not</u> 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

(question released November, 1994)

19. 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 <u>neither</u> is compelled to buy or sell.
E. current insured value.

(question released November, 1994)

20. 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

(question released November, 1994)

21. 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

(question released November, 1994)
22. 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

(question released November, 1994)
23. 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 <u>not</u> 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.

Below is the CFP Board of Examiner's response to a candidate's question regarding this exam item.
The AGI limits do not apply here. The question states that the company does not cover him under a qualified pension plan. The AGI limits only apply where an individual is covered under a qualified plan.

(question released November, 1994)
24. 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. <u>no</u> 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.

(question released November, 1994)
25. 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.

(question released November, 1994)
26. Which one of the following statements about life insurance products and their tax attributes is correct?

A. Modified endowment contracts do <u>not</u> provide a tax-free death benefit if the policyholder dies prior to age 59_.
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 <u>no</u> 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.

Below is the CFP Board of Examiner's response to a candidate's question regarding this exam item.
D is indeed the correct answer because immediate annuities are not subject to a premature distribution penalty tax. This only applies to deferred annuities.

(question released November, 1994)
27. If the market risk premium were to increase, the value of common stock (everything else being equal) would

A. <u>not</u> change because this does <u>not</u> 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.

(question released November, 1994)
28. 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

(question released November, 1994)
29. 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

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

(question released November, 1994)

30. 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 _ 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

Below is the CFP Board of Examiner’s response to a candidate’s question regarding this exam item.
#3 option is incorrect because the maximum contribution is the less of 25% of compensation or the applicable dollar figure for the year in which the annual addition is made. Thus, if an employee’s compensation were $200,000, the addition would be the less of 25%x$200,000-$50,000 or $30,000. Note that the $30,000 would be the maximum and would be less than the 25%.

(question released November, 1994)

31. 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)

(question released November, 1994)

32. 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)

(question released November, 1994)
33. 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)

(question released November, 1994)
34. 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)

(question released November, 1994)
35. 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)

(question released November, 1994)
36. Which of the following 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)

(question released November, 1994)
37. 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)

(question released November, 1994)
38. 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)

(question released November, 1994)
39. 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)

(question released November, 1994)
40. 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

(question released November, 1994)
41. 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)

(question released November, 1994)

42. A client, age 70, a widower with <u>no</u> 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)

Below is the CFP Board of Examiner's response to a candidate's question regarding this exam item.
The clarification on why (3) above is incorrect is that a comprehensive major medical policy would pay for treatments for the arthritis but not for the custodial care which is required because he cannot perform the functions of daily living; i.e., dressing, feeding, bathing, etc.

(question released November, 1994)

43. 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)

(question released November, 1994)
44. 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

(question released November, 1994)
45. 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

(question released November, 1994)
46. 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

(question released November, 1994)
47. 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)

(question released November, 1994)
48. 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

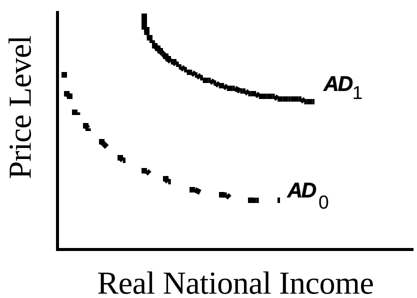
Assuming the couple could qualify for both mortgages, which of the following aspects should be considered in deciding between these two mortgages?

(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)

Below is the CFP Board of Examiner's response to a candidate's question regarding this exam item.
The question tries to eliminate the need to include (1) gross income as part of the answer by stating in the fact pattern the couple could qualify for both mortgages.

(question released November, 1994)
49. Movement through the phases of the business cycle is initiated by shifts in aggregate demand which 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

(question released November, 1994)

50. 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

(question released November, 1994)

51. 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)

(question released November, 1994)

52. 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)

(question released November, 1994)

53. A client purchased a mutual fund with a $10,000 lump-sum amount four years ago. During the four years, $4,000 of dividends were 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)

(question released November, 1994)

54. 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)

(question released November, 1994)

55. 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)

(question released November, 1994)

56. 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