Case #9: Richard and Susan

NOTE: This is a long 25 question case and rather difficult. It should take you at least 60-70 minutes. Please watch your timing. From time-to-time, the exam has longer cases. This is a good case to practice.

Richard

- 56 years old
- Physician (cosmetic surgery), president of Make Me Beautiful, PA* (A corporation)
- Salary with year-end bonus ($500,000 total)
- Has been sued twice for malpractice (won both) in past year, excessive court costs, coverage not renewed by carrier (going "bare")
- Hopes to retire by age 65
- Divorced, married Susan in 2004
- Alimony payments due to first wife of $60,000/year for 4 more years
- First wife "wiped him out," therefore has a basic prenuptial agreement with Susan (all separately owned assets to his children)
- His only will has the following provision: "All my separately owned property to my children William and Diane."

Susan

- 51 years old
- President of Trends, Inc.
- Net income $250,000
- Second marriage, received generous settlement from a messy divorce
- Receives child support of $20,000/year for 4 more years
- Her only will has following provision: "All my separately owned property to my children Elizabeth and James."

Richard's Children
William, age 26, is finishing medical school.
Diane, age 21, finishing college now, plans to be an attorney.
Richard pays the educational institutions directly for tuition, room, and board. Richard's estimated educational expense for Diane will be $40,000 per year for another 3 years.

Susan's Children
Elizabeth, age 17, in private high school ($10,000/yr.), plans to go to college.
James, age 14, in private jr. high school ($10,000/yr.), plans to go to college.
Elizabeth and James work part-time at Susan's store, and they are interested in joining their mother after college.

Susan hopes Elizabeth and James will complete their college education in 4 years (no graduate school). Susan will be responsible for their education (estimated to be $20,000 per year per child). **NOTE:** The children have nothing to do with their father.

* A PA (Professional Association) is a regular corporation. Because he is a physician (HALE), the corporation is a personal service corporation (PSC).

RICHARD AND SUSAN
STATEMENT OF FINANCIAL POSITION

Cash/Cash Equivalent		**Liabilities**	
Checking Account (JT)	50,000	Home Note Balance (JT)[11]	250,000
Money Market deposit (JT)[1]	100,000	R.E. (Store) Loan (S)[7]	250,000
Money Market account (S)[1]	100,000	Laser Equipment (R)[9]	950,000
Certificate of Deposit (S)[1]	100,000		
Total Cash / Cash Equivalent	$350,000	Total Liabilities	$1,450,000
INVESTED ASSETS			
Profit Sharing 401(k) (R)[2]	1,000,000		
Value Plus Fund (S)[3]	300,000		
Whole Life (S)[4]	50,000		
Muni Bonds (R)[5]	150,000		
Mutual Fund X (R)[6]	500,000		
Real Estate (Store) (S)[7]	1,000,000		
Retail Store - Net Book Value (S)[8]	200,000		
Laser Equipment (R)[9]	1,000,000	NET WORTH	$ 5,200,000
P.A. Stock (R)[10]	200,000		
Total Invested Assets	$ 5,000,000		
USE ASSETS			
Personal Residence (JT)[11]	1,000,000		

Personal Property	200,000
Misc. Autos (R)[12]	50,000
Auto (S)	50,000
Total Use Assets	$1,300,000

TOTAL ASSETS	$ 6,650,000	TOTAL LIABILITIES AND NET WORTH	$ 6,650,000

JT means owned by Richard and Susan in **tenancy by the entirety**
S means solely owned by Susan
R means solely owned by Richard

[1] The money market accounts and certificates of deposit are at All American Savings & Loan. The CD is maturing shortly. The checking account is at a different bank.
[2] The 401(k) is with a money manager [the 20011 return was +15, the 20012 was -20, the 20013 was +15, and the 2014 return was 10]. Current year results are slightly positive. The money manager has stayed in the equity market.
[3] Part of Susan's divorce settlement (basis $50,000)
[4] Cash value includes cash value of the paid up additions
[5] Purchased over a year ago at 95 (basis $118,750) The bonds have a 6% coupon and are now selling at a premium.
[6] Purchased Mutual Fund X as follows:

5+ years ago	$100,000 @ $15/share (6,666.667 shares)
4+ years ago	$30,000 @ $15/share (2,000 shares)
3+ years ago	$100,000 @ $13/share (7,692.307 shares)
2+ years ago	$100,000 @ $12/share (8,333.333 shares)

The fund management changed the mix into bonds and natural resources over a year ago.
The current share value is $20 per share.
[7] See "Details on Susan's Real Estate (Store)" page 6-4 Mortgage is in her name.
[8] See "Details on Susan's Store" page 6-4
[9] See "Details on Richard's Laser Equipment" page 6-5 Mortgage is in his name.
[10] See P.A. stock page 6-5
[11] The home (basis $600,000) was purchased when Richard and Susan got married.
[12] Richard trades cars every 2 years. He pays cash. He also furnishes his two children with autos plus gas and upkeep.

ESTIMATED INFLOW AND OUTFLOW FOR 2014

INFLOWS	<u>ANNUAL TOTAL</u>	
Richard's salary [net of 401(k) deferral]	500,000	
Susan's net income	250,000	
Capital gains/dividends from mutual funds	Minimal	
Muni bonds	———	
Interest CD and money market interest	5,000	
Laser	10,000	
Real estate (store)	28,000	
Child support		<u>20,000</u>
Total inflows	$	
OUTFLOWS		
Federal income tax	185,000	
FICA	15,000	
Real estate	10,000	
Housing & home maintenance	42,000	
Transportation	30,000	
Food & beverage	30,000	
Clothing	25,000	
Furnishing	25,000	
Personal case & cash	10,000	
Insurance (life, disability, etc.)	———	
Education (four children)	60,000	
Entertainment, dining, gifts	60,000	
Vacations	25,000	

Charitable contributions		30,000
Alimony		______
Miscellaneous		25,000
	Total outflows	$
	Savings (loss)	$

DETAILS ON SUSAN'S REAL ESTATE STORE

-- Susan owns the building in her name.

-- Her building value is soaring due to her trendsetter store being in an upscale shopping area.

-- The store building is leased to the business, and lease payments more than cover loan payments and property expenses.

-- Susan is considering increasing the lease payment to produce a positive cash flow above property cost (estimated tax-free cash flow of $28,000 last year).

-- Susan would like to "income split" extra cash flow with her children from the real estate without losing control. In addition, she would like to retain existing tax losses and eventually take retirement income from this asset but remove it from her estate for the benefit of her children.

SUSAN'S BUSINESS OWNER'S POLICY

Coverage/Insured	**Building and contents**
Deductible	**$250 per calendar year**
Building/Contents coverage	**$400,000/$200,000**
Replacement Cost	**Yes**
Liability	**$1,000,000**
Medical Payments	**$5,000 per person / $50,000 per occurence**
Non-Owned Auto	**Covered**
Loss of Earnings	**Included**
Premium	**$5,000/year**

WORKERS COMPENSATION -- SUSAN'S STORE

Covered Employees	Susan did not elect coverage.
Liability	$100,000 each accident / $100,000 each employee 500,000 policy limit
Premium	$2,800/year

DETAILS ON SUSAN'S STORE

-- The retail store is a trendsetter (sells clothing).

-- The net income has grown since the start-up year at 50% per year and is stable.
-- Initial key employees have come and gone. Susan would like to retain key employees by contributing to a qualified plan. Susan has a lot of part-time and seasonal employees (Easter, Christmas, Valentine's Day). Reporting requirements are not an issue.
-- Susan is considering opening up additional stores, and wealthy clients have shown "interest" in investing in or owning new stores.
-- Elizabeth and James (Susan's children) work part-time at the store, and they are interested in joining their mother in her business after college. She would like the children to become owners over a period of time should they join her.
-- Because of Richard's malpractice and liability concerns, Susan wants adequate liability protection and wants to be able to isolate this asset from Richard's creditors.

SUSAN'S STORE EARNINGS HISTORY

Year	12/31/2012	12/31/2013	12/31/2014
Salary	$100,000	$150,000	$200,000
Corporate profit	$43,500	$73,000	$100,000

-- Pension objectives:
1. It is important to maximize benefits for Susan.
2. It is important to reduce the corporate income tax.
3. The maximum amount the business could have contributed to a qualified plan last year was $60,000, and the projected maximum amount the business will be able to contribute this year would be $100,000.

EMPLOYEE CENSUS
TRENDS INC – 2015

Full-time Eligible Employee	**Name**	**Age**	**Employment Years**	**Compensation**
1	Susan	51	3	$265,000
2	Staff 1	31	2+	57,000
3	Staff 2	30	1+	48,000
4	Staff 3	22	1+	35,000
				$405,000

DETAILS ON RICHARD'S LASER EQUIPMENT

-- Richard purchased a "state of the art" laser wrinkle remover. The laser stimulates new skin growth by regenerating skin energy levels using electromagnetic radiation. The procedure is still considered "experimental" with long-term effects still unknown.

-- All three doctors will use the laser equipment (wrinkle remover).

-- The P.A. will lease equipment on an hourly basis. Cash flow will be outstanding. Excessive cash above loan payments should generate substantial future income to Richard. Loan repayments will be minimal to keep the loan at maximum for the life of the equipment. The original price of the equipment was $1,000,000. Richard paid $50,000.

-- Richard could not find an insurance carrier to insure the equipment for liability protection. The existing carrier issued a "Named Perils" policy but with an exclusion for all liability or malpractice claims. Malpractice is a concern.

-- Richard would like to "income split" extra cash flow from the equipment lease with his children without losing control. In addition, he would like to retain existing tax losses, and eventually take a retirement income from this asset (if still usable) but remove it from his estate for the benefit of his children and protect it from malpractice claims.

PROJECTED AFTER-TAX NET CASH FLOW FROM THE LASER EQUIPMENT

First year	$10,000	(tax free)
Second year	30,000	(tax free)
Third year	50,000	(subject to tax)
Fourth year	50,000	(subject to tax)
Fifth year	20,000	(subject to tax)
Sell (fifth year)	100,000	(subject to tax)

LASER EQUIPMENT FLOATER

Type	Named perils
Property Value	$1,000,000
Liability / medical payments	None-complete exclusion
Exclusions	Complete exclusion for malpractice
Premium	$2,500/year

DETAILS ON RICHARD'S PRACTICE

--The P.A. was established in 1998. The P.A. has very little in retained earnings. All earnings are zeroed out at year-end. The P.A. has about$1,300,000 of accounts receivable at all times. The doctors agree that because of their established name, goodwill in the community is worth $200,000. Therefore, they agreed to a cross-purchase agreement purchase price of $500,000. It will be funded by receivables and cash value of split-dollar policies should one doctor die.

-- Richard has two other physician shareholders (own 1/3 each). The three doctors established a P.A. seven years ago. The other doctors are slightly younger than Richard, and they have the same P.A. life and disability policies as Richard. All the other employees have individual disability policies paid by the P. A. under a salary continuation plan.

-- Malpractice premiums have skyrocketed due to recent claims against all of the doctors. Asset protection is a major concern of all three doctors.

Employee Census - 2015
Make Me Beautiful, P.A.

	Employee Name	Attained Age	Retirement Age	Sex	Compensation
1	Richard	56	65	M	$500,000
2	Doctor 2	55	65	M	400,000
3	Doctor 3	52	65	M	300,000
4	Staff 1	45	65	F	50,000
5	Staff 2	27	65	F	32,000
6	Staff 3	25	65	F	32,000
7	Staff 4	22	65	F	25,000

The profit -sharing 401(k) plan allows for maximum deferrals ($18,000 plus catch-up) plus a 6% match. Normally, the P.A. then adds a profit-sharing contribution (Richard will get $53,000 without catch-up).

DETAILS OF BUSINESS INSURANCE

WORKERS COMPENSATION -- RICHARD'S P.A.

Premium	**$1,228/year**
Coverage / Location	**P.A. Employees**

Covered Employees	**All doctors elected not to be covered.**
Liability	**$100,000 each accident** **$100,000 each employee** **$500,000 policy limit**

MAJOR MEDICAL -- RICHARD'S P.A.

Premium	$5,000/month
Type	Group-all employees are covered, family optional.
Insured	Richard, Susan, Diane, Elizabeth, and James
Deductible	$300 per calendar year
Accident	Deductible waived for accidents
Coinsurance	80/20 of $5,000
100%	$1,000,000
Maternity	Complications only
Preexisting	6/12
Mental/Nervous	Limited

SPLIT-DOLLAR POLICY -- RICHARD'S P.A.

Premium	Cash value paying premium
Owner/Insured	Make Me Beautiful / Richard
Type	Split-dollar - endorsement method
Face amount	$200,000 - universal option B increasing
Premiums paid	$55,000
Cash Value	$50,000
Beneficiary	Make Me Beautiful / Susan

INDIVIDUAL DISABILITY -- ALL EMPLOYEES

Coverage/Insured	Richard
Premium	$15,500/year
Base $ per month	$17,250/month
Elimination period	90
Sickness/Accident Term	Life - 60/lifetime

Options	Residual/COLA/Social Security Supplement of 800/mo. (expected S.S. Benefits $1,200/mo.)
Premium Payor	P.A. (paid under a salary continuation plan)

PROFESSIONAL LIABILITY

Unavailable - $250,000 surety bond enables the P. A.'s doctors to practice at a hospital.

DETAILS OF PERSONAL INSURANCE

RICHARD'S LIFE INSURANCE

Carrier	Mutual Insurance Company
Premium	$1,000/year
Coverage/Insured	Richard
Type	5-year level term
Life Amount	$500,000
AD&D	None
Disability waiver	None
Owner	Richard
Beneficiary	Susan
Contingent Beneficiary	William & Diane

SUSAN'S LIFE INSURANCE

Carrier	Mutual Insurance Company
Premium	$3,000/year (purchased 15 years ago)
Coverage/Insured	Susan
Type	Whole life (cash value shown previously)
Life Amount	$250,000
AD&D	None
Disability waiver	No
Dividends	Buying paid up additions (shown previously)
Owner	Susan

Auto Insurance – Premium $2,000/yr.

Homeowners Insurance – Premium $2,000/yr.

1. Richard is disgusted with the 401(k) money manager (because he charges 2%). He wants to divide up the pooled 401(k) assets among the participants. Each participant will now invest their own separate account. Richard has narrowed the field to five mutual funds. He wants a conservative, diversified portfolio with reduced volatility and variability. What do you suggest?

Fund #1 (Gold)	5-year return -3.1%, Beta -,05 Alpha 10.8 R^2 0 Std dev 26.21%
Fund #2 (Balanced)	5-year return +10.6%, Beta .58 Alpha 6 R^2 68 Std dev 11.70%
Fund #3 (International Value)	5-year return 2.1%, Beta .72 Alpha -1.6 R^2 60 Std dev 15.37%
Fund #4 (Growth & Income)	5-year return 4.4%, Beta .44 Alpha -1.4 R^2 26 Std dev 14.98%
Fund #5 (Small Cap)	5-year return 3.7%, Beta 1.12 Alpha 9.9 R^2 41 Std dev 28.97%

A. 20%#1; 30%#2; 20%#3; 30%#4 Weighted Std Dev 16.31 Weighted Beta .44
B. 10%#1; 20%#2; 40%#4; 30%#5 Weighted Std Dev 20.37 Weighted Beta .65
C. 10%#1; 40%#2; 30%#4; 20%#5 Weighted Std Dev 17.99 Weighted Beta .58
D. 30%#2; 30%#3; 30%#4; 10%#5 Weighted Std Dev 15.51 Weighted Beta .63

2. Susan's daughter, Elizabeth, contracted pneumonia last spring. Initial doctor bills and medicine, totaling $300 were claimed. However, because of the illness, Elizabeth was subsequently hospitalized, incurring another $5,000 in claims. How much of the $5,300 claim will be paid by Richard or Susan?

A. $1,000
B. $1,300
C. $4,000
D. $5,000
E. $5,300

3. What is the total of Richard and Susan's inflows for 2014?

   A. $793,000
   B. $800,000
   C. $800,500
   D. $813,000
   E. $820,500

4. What is the total of Richard and Susan's outflows for 2014?

   A. $520,000
   B. $580,000
   C. $632,000
   D. $640,000
   E. $655,500

5. If Susan adopts a profit-sharing plan this year, which vesting schedule would you suggest?

   A. 100% vested with 2 years of service
   B. 2-6 year graded
   C. 3-7 year graded
   D. 5 year cliff

6. Richard is going to trade his car (trade-in value of $40,000) for a new car ($80,000). He needs $20,000 in additional cash. Which of the following of Mutual Fund X should he sell to pay the minimum tax?

   A. 833.33 shares purchased 2+ years ago plus 166.67 shares purchased 5+ years ago
   B. 200 shares purchased 4+ years ago plus 800 shares purchased 2+ years ago
   C. 769.23 shares purchased 3+ years ago, 100 shares purchased 4+ years ago, and 130.87 shares purchased 2+ years ago
   D. 400 shares purchased 5+ years ago plus 600 shares purchased 2+ years ago

7. If Susan adopted a retirement plan, which of the following would be the most appropriate plan to install at Trends, Inc.? Please take into account the important factors from the case data that affect the selection for 2015.

   HINT: There is a mini-chart in the Live Review R-26 about selecting an integrated plan or an age-weighted plan.

   A. 20% money-purchase plan
   B. Profit-sharing plan integrated with social security that focuses on Susan getting $53,000 yearly
   C. 401(k) plan with a 6% match/profit-sharing contribution.
   D. 20% SEP
   E. Age-weighted target benefit plan that focuses on Susan getting $53,000

8. If Richard becomes totally disabled during the current year, what can he expect in the form of disability payments? If he remains disabled beyond one year, will that change? (Difficult)

   A. The PA will guarantee 60% of his current income through salary continuation and disability payments. If he receives social security payments, they will offset the 60%.
   B. He will get $18,050 a month (taxable) for the first year (after the 90-day wait). After one year, he will get $17,250 a month (taxable).
   C. He will get $17,250 a month (tax-free) (after the 90-day wait) and he will also get $800 a month as a social security supplement (tax-free) for as long as he is not eligible for any social security di
   D. He will get $17,250 a month (taxable) (after the 90-day wait), and he will also get $800 a month (taxable) for as long as he is not eligible for any social security disability payments.
   E. He will get $18,050 a month (taxable).

9. Susan is considering moving her money market money (making 1%) and her maturing CD into new accounts. She wants to split it as follows: $100,000 in joint name with Elizabeth and $100,000 in joint name with James. How much of the $200,000 will be insured?

   A. $100,000
   B. $150,000
   C. $200,000
   D. $300,000

10. When Susan took out her whole life policy 15 years ago, she felt she needed the policy until the children were grown. Now she feels she doesn't need the policy. Considering the facts of the case, which do you feel is her best alternative?

    A. Leave the policy alone
    B. Cash the policy in to partially fund Elizabeth's college education
    C. 1035 the policy into a 10-year immediate annuity to defer taxable income (estimated at $6,000/year)
    D. Exercise a reduced paid-up nonforeiture option (estimated $100,000 death benefit)
    E. Roll the whole life policy into a new $250,000 variable life policy and borrow out the cash value

11. If Richard and Susan were new potential clients, what is the least important action a CFP® practitioner would have to do?

    A. Give the clients a list of prior clients
    B. Disclose the financial planning practitioner's compensation arrangement
    C. Establish the duration of the engagement
    D. Provide information necessary to define or limit the scope
    E. Determine the clients' and the financial planning practitioner's responsibilities

12. Richard is concerned about malpractice. What does he own that would be subject to creditors?

    I. Home

    II. Money market fund

    III. Laser equipment

    IV. PA stock

    V. Profit-sharing 401(k)

    A. I, II, IV
    B. I, II
    C. II, III, IV
    D. III, IV
    E. V

13. Richard wants to fully fund the buy-sell arrangement with life insurance. Which of the following statements is incorrect?
    HINT: This is a 3-doctor group.
    NOTE: This is a high-degree of difficulty question.

    A. If the split-dollar policy were sold by the P.A. to Richard, then it would be subject to transfer-for-value rules.
    B. If each officer took out a $100,000 policy on each other officer, then there would be a transfer-for-value problem at one of the officers' deaths.
    C. Whether a cross-purchase or stock redemption method is used, the premiums for the insurance are not deductible.
    D. A cross-purchase arrangement gives the surviving officers a step-up in basis and makes the policies creditor proof.
    E. If a stock redemption-type buy-out is used, the life insurance would be subject to the P.A. creditors.

14. Richard would like to add more employee benefits. Considering that the financial doctors will make the decision, which two corporate benefits would you recommend the officers consider?

    I. Group dental

    II. LTC

    III. Short-term disability

    IV. Group life ($50,000)

    V. Group legal

    A. I, II
    B. I, III
    C. II, III
    D. II, IV
    E. IV, V

15. 30-Forever, Inc. makes the laser. The company stock (listed) has a lot of potential volatility. Richard would like to buy 1,000 shares at 50 on margin. The brokerage house is requiring 30% maintenance margin requirement. At what per share price will Richard get a margin call if the stock falls?

    A. $31.25
    B. $33.00
    C. $35.71
    D. $38.33
    E. $41.67

16. Richard feels that interest rates are as low as they can get. His municipal bonds are selling at a premium. Which of the following is true?

    A. If he sells the bonds, the gain on the bonds would be short-term (municipal bond tax rules).
    B. If he sells the bonds, he cannot repurchase them for 30+ days to take the loss.
    C. He should keep the bonds; the current yield is greater than the yield to maturity.
    D. There is no taxable gain on municipal bonds.

17. Susan is considering opening another store. She will need $100,000 worth of business equipment (7 year property). If she uses MACRS (14.29%) and section 179, how much can she expense in 2013?

    A. Zero. It has to be 1245 property.
    B. $100,000
    C. $14,290
    D. 50% of $500,000 because she will use MACRS

18. One of the non-owner employees of Make Me Beautiful was hurt assisting a grossly overweight patient. Which of the following would be true if there was medical treatment and disability coverage?

    A. The individual disability income policy benefits will be tax-free income to the non-owner employee.
    B. The workers compensation benefits for medical treatment will be tax-free.
    C. The medical benefits will be covered under the group major medical coverage with the deductible waived.
    D. The workers compensation benefits for disability will be taxable.
    E. All benefits paid would be tax-free.

19. Based on the case information, which of the following techniques best fits the future ownership of the laser equipment?

    A. Private annuity with his children
    B. Installment sale with his children
    C. Family limited partnership with his children as limited partners
    D. S corporation with his children gifted nonvoting common stock
    E. Gift and leaseback with his children

20. Considering the other facts of the case, which of the following trusts should Richard consider in planning for Susan?

    I. Bypass (credit shelter) trust

    II. Qualified terminal interest trust

    III. Marital A trust

    IV. 2503(c) trust

    V. Spousal remainder trust

    A. I, II, III, V
    B. I, II, III
    C. I
    D. II, IV
    E. III, V

21. Susan would like to "income split" potential lease payment cash flow from the real estate (her store). If she incorporated as an S corporation and paid some of the income to her children, which of the following is /are true?

    I. Only certain types of trusts can be used with S corporations.

    II. A depreciation write off on the real estate property would be limited to cash she put up plus the actual loans she personally made to purchase the property (not non-recourse loans).

    III. Susan could issue common and preferred stock and, then transfer the dividend-paying preferred stock to her children.

    IV. The income James would receive would be subject to the kiddie tax.

    V. The income would be unearned income.

    A. I, II, III, IV
    B. I, II, IV, V
    C. II, V
    D. III, V
    E. II, IV

22. If Susan income splits using a partnership arrangement for the real estate (her store), which of the following are correct statements about the taxation of income going to her children?

    I. The kiddie tax will probably affect both James and Elizabeth in 2013.

    II. The partnership ownership and income can be owned by UGMAs, UTMAs, or 2503(c) trusts for income-tax purposes.

    III. Income accumulated in the 2503(c) will be taxed at the trust rates.

    IV. If Susan is both the grantor and trustee of the children's 2503(b) trusts, the trusts will be tainted (defective) trusts for income-tax purposes.

    A. I, III, IV
    B. I, II
    C. I, III
    D. II, IV
    E. III, IV

23. If Richard were to change the P.A. pension plan, what would you suggest and why?

    A. Leave the plan unchanged as Richard is maxing out at $51,000
    B. Change to a 20% money-purchase plan to make sure the P.A. makes mandatory contributions of $51,000
    C. Change to a defined benefit plan with a social security offset to maximize contributions for the three owners
    D. Change to a 20% pure profit-sharing plan to make sure the P.A. makes a contribution of $51,000
    E. Terminate the plan and roll all the money into IRAs to allow each individual to invest as they see fit

24. Susan pays Elizabeth $10 per hour and James $7.50 per hour. Elizabeth works about 1,000 hours a year, and James 500 hours a year. Which of the following is true?

    A. Elizabeth and James would each get a standard deduction of $1,000.
    B. Elizabeth and James would not be subject to social security or Medicare taxation because they are employed by their mother.
    C. Elizabeth and James would be subject to self-employment taxes.
    D. Both Elizabeth and James will be subject to FICA and FUTA taxes.
    E. Elizabeth and James should elect to take their own personal exemptions to reduce their income taxes.

25. What kinds of additional personal insurance and business insurance does Susan need?

I. Major medical

II. Personal umbrella

III. Key person life

IV. Disability buyout

V. Individual disability

A. All of the above
B. I, II, III, IV
C. II, III, IV
D. II, III, V
E. I, V

Case 9 Answers

1. **Answer: D**
   Answer D has a weighted standard deviation of 15.51% (variability) and a weighted beta of .63 (volatility). Answer A is very close with 16.31% and .44. I felt the standard deviation was more important than beta because of the R^2 of the funds (Sharpe). Make your best guess and move on. This question can consume your time and energy.

2. **Answer: B**

Claim	$5,300	
Deductible	$300	300
	$ 5,000	
	x 20%	
	$1,000	+1,000
	TOTAL	$1,300

3. **Answer: E**

Inflows shown	$813,000	
Muni bonds	7,500	*
	$820,500	

*(6% of $125,000) He bought the bonds at $118,750 ÷ .95 = $125,000 par value
The bonds were bought at a discount. See footnote #5. **This is a difficult.**

Richard's 401(k) deferral is already netted out to keep the questions and answers simple.

4. Answer: D

Outflows shown	$572,000
Personal insurance	*8,000
Alimony	60,000
	$640,000

*Richard's life $1,000, Susan's life $3,000, homeowners $2,000, auto (2 x $1,000) $2,000
The laser insurance is already factored into the projected after-tax cash flow. The laser is business property.

5. Answer: B
   The plan is top-heavy 265,000 ÷ 405,000 = 65%. Tax Act 2006 requires the faster vesting schedule (2-6) prior to the act you could use 3-7. So calculation top-heavy only affects defined benefit plans. A non-top heavy DB could use Answer D. Answer D is irrelevant in this question. The $265,000 is the maximum allowable compensation for 2015.

6. Answer: D
   The higher the basis, the lower the tax (Answer D).
   Answer A (833.33 x $12) + (166.67 x $15) = $12,500
   Answer B (200 x $15) + (800 x $12) = $12,600
   Answer C (769.23 x $13) + (100 x $15) x (130.87 x $12) = $13,070
   Answer D (400 x $15) + (600 x $12) = $13,200
   WARNING: If it took you more than 3-4 minutes to do this question, you should do it last. These are time wasters.

7. Answer: E
   Susan will get the maximum benefit ($53,000) under the age-weighted target benefit plan; younger lower-paid employees will get some benefits under the plan. Contributions for those employees under the plan. Answer A is a mandatory 20% for all full-time employees. Answer D would require a 20% contribution, and she would have to include part-time year-to-year employees. In addition the case data says "she would like to contribute to a qualified plan." A SEP is not a qualified plan. My age-weighted chart from the Live Review leans toward my answer. See chart in Live Review R-26 but the factors are below.
   CHART
   Integrated with Social Security
   1. Owner's age is 50 or under.
   2. Owner's income is under $200,000 per year.
   3. Rank -and-file employees are making under $90,000 or less. +1

   Age-weighted target benefit plan
   1. Owner's age is 50 or older +1.
   2. Owner's income is over $200,000 per year. +1
   3. Rank-and-file employees are younger than the owner. +1

8. Answer: D
   The P.A. paid the premium under a salary continuation plan (and deducted the premium). This is covered in the Live Review I-23. This is a very important page. The social security disability is an offset rider. If he does not qualify for social security, he will continue to get the $800 per month. Please review Live Review Insurance I-23 for all the taxation of disability rules.

9. Answer: C
   Susan gets $100,000; Elizabeth gets $50,000, and James gets $50,000. She also has $100,000 with Richard. She has already used up $50,000 joint in connection with her husband's joint account. It is only asking about the $200,000, not the joint with her husband. The footnote says the checking account is at another bank. The money market deposit account is at the bank. It is insured.

10. Answer: B
    It says she feels she doesn't need the policy (Answer A). The basis of the policy is $45,000. The gain on surrender is minimal. Taking cash gives her more flexibility than an annuity. Answer D ties up her cash and the death benefit will only be $100,000 with a cash value of $50,000. Answer E may or probably will create a MEC. Why? Because the cash value transfer is going to look like a single premium. In addition, she does not need the coverage.

11. Answer: A
    Prior to providing any financial planning service, a CFP® certificant and the client shall mutually define the scope of the engagement. This is accomplished by Answers B, C, D and E along "identifying the services to be provided." Giving a client a list of prior clients can only be done if the clients agree and is not part of the planning process.

12. Answer: D
    Tenancy by the entirety (TBE) and the 401(k) will be creditor proof. Ownership of the laser equipment and PA stock is in his name. Yes, the mutual funds would be subject to the creditors, but they are not part of the answer to the question. **Reference**: Live Review Estate E-4 TBE creditor proofing

13. Answer: A
    A sale to the insured (Richard) does **not** create a transfer-for-value problem. When one of the officers dies, there is a transfer-for-value problem with Answer B. Example: If Richard dies, he owns two $100,000 policies on the other doctors. Can Doctor #2 buy from Richard's estate the policy he owns on Doctor #3 ($100,000 policy)? No, only Doctor #3 can buy the policy. Reference Live Review book I-37. The transfer-for-value occurs when one of the three doctors die and the remaining two doctors want to buy the policies from the deceased doctor's estate.

14. Answer: D
    $50,000 of Group life would be tax-free. LTC would be a good benefit at their age. Short term disability has limited disability benefits. Group legal is inexpensive. It covers basic legal needs like wills and trusts. But, Richard has big time needs. It would not help him or the other doctors very much. Group dental is also very limited.

15. Answer: C

$\frac{1 - .50}{1 - .30} \times \$50 = \$35.71$

NOTE: The $50 per share is part of the question.

Shortcut: 2/3 of $50,000 = $33.33 pick the next highest number $35.71

16. Answer: C

The bonds would be taxed at the long-term capital gains rate. Only original issue OID munis avoid capital gains tax. The bonds are sold at a gain not a loss (wash sale). Remember YMCA. The bonds were originally bought at a discount. YTM was greater than current yield. However, the bonds are now selling at a premium. The current yield is greater than YTM. He should probably sell them, but both answers A and B are incorrect. You are forced into answer C.

17. Answer: B

Equipment is 1245 property. The limit on 179 is $25,000. The other $75,000 can be depreciated at 14.29% ($10,717.50). The total deduction is $35,717.50.

18. Answer: B

Workers compensation benefits (medical and disabilty) are always tax-free. A major medical policy normally has an exclusion for job-related injuries. All employees have individual disability policies paid for and deducted by the P.A. The benefit will be taxable (Answer A).

19. Answer: C

The family limited partnership accomplishes all his objectives, and it is **somewhat** creditor proof. Please review intrafamily planning techniques page E-37. S corporation is also a good answer. I think on the exam both answers would not be there. I think the FLP fits better than the S corporation. Remember the laser wrinkle remover is capital sensitive and is perfect for income splitting. The gift leaseback will not work. It says he wants to income split without losing control. With a gift leaseback he loses control and he pays for the lease.

20. Answer: C

Since the by-pass can absorb up to $5,430,000, there is no need for a QTIP. Using a Marital A trust would mean Richard would pass his assets to Susan (loss of postmortem control). A 2503(c) is for children. Spousal remainder trusts are no longer usable after 1986 and don't apply even if they were usable. Please read the objectives. Since answer III is usable, Answer C is the best choice.

21. Answer: B

    An S corporation's stock would have to go in a qualifed subchapter S trust with Crummey provisions. Answer II is true. S corporations cannot issue preferred stock. James is age 14 (a kiddie). Answer V is true.

22. Answer: A

    Answer I is true. She may turn age 18 this year, but the kiddie tax last until age 24. Answer I says probably. James is age 14. Answer II is false. You cannot put real property (real estate) in a UGMA. Answer III is true. Answer IV is true. This is beneficial enjoyment. She is both the grantor and trustee. The trust income would be taxable to Susan.

23. Answer: C

    Richard saves over $100,000 per year. When you solved questions 1 and 2, you get the inflows and outflows. The defined benefit plan would reduce his income and taxes, shelter his assets from malpractice (ERISA), and better fund his retirement goals. The question says, "were to change."

24. Answer: D

    Because James (earned $3,750) will get a standard deduction of $3,750 + $350, he will pay no **income** taxes. Elizabeth at $10,000 year would be subject to income taxes (earned income). Trends, Inc. is a corporation. Wages for both children would be subject to FICA and FUTA. This is the only correct answer. If Susan were self-employed, no self-employed tax would be due. However, she is a corporate entity.

25. Answer: D

    Richard's P.A. provides hospitalization for Susan and her children. She needs disability overhead. She has no one to do a disability buyout with. The debatable answer is the major medical for her employees. The roman numerals eliminated it.