Book 7: Financial Planning
Case Studies
Case Study 12: Susan Wood
Case Study Facts

Today is December 31, 2018. Susan Wood has come to you, a CFP® professional, for help in developing a plan to accomplish her financial goals. From your initial meeting together, you have gathered the following information.

**PERSONAL BACKGROUND AND INFORMATION**

**Susan Wood (Age 50)**
Susan and her brother, Glen East, along with their mother, Maude, own EastWood Architectural, a C corporation. Susan is divorced with one daughter, Audrey (age 30), and a grandson, Billy (age 2).

**Glen East (Age 45)**
Glen is Susan’s brother and a co-owner of EastWood Architectural, together with Susan and their mother, Maude. He is age 45 and married to Ruth, age 42. Ruth is a stay-at-home mom. They have two children, Matt, age 11, and Sarah, age 8.

**Maude East (Age 74)**
Maude is 74 years old. Maude’s home has a fair market value of $120,000 and no mortgage debt. She receives a modest pension benefit of $12,000 per year from her late husband’s employer. She also receives Social Security benefits of $15,000 per year. Her most significant source of income has been interest earned on CDs and government bonds. With the decline in interest rates, her discretionary income has decreased significantly, and she is concerned about having sufficient funds to take care of herself. Her 20% interest in the business is her single largest investment.

**EastWood Architectural**
Susan, Glen, and Maude own EastWood Architectural (EastWood), a C corporation. Susan and Glen each own 40% of the stock, and Maude owns the remaining 20%. Susan and Glen formed the company 15 years ago with their personal funds and a capital contribution from Maude.

EastWood drafts architectural plans for several different venues, including small office complexes, small-to-medium-sized retail centers, and small resorts. Susan and Glen both believe the business has significant growth potential. The firm has been approached for other projects, such as a local government office complex and an upscale retail center.

Today EastWood employs a total of 15 people—Susan, Glen, seven architects, and six administrative office personnel. The firm grossed $3 million last year and had a profit of $700,000. Susan and Glen have not had the firm appraised but believe its reasonable fair market value is $4.5 million. The firm does not pay dividends. Maude has indicated to both Susan and Glen that she would like to start receiving income from the business or sell her stock to Susan and/or Glen.

Susan and Glen each receive a base salary of $250,000 per year. The other seven architects receive salaries ranging from $75,000 to $175,000. Salaries for the remaining office personnel from $18,000 to $50,000.
Susan and Glen are interested in providing additional benefits that would help them retain their current employees and attract the talent they need to remain competitive. They are also interested in creating a market for their stock. Neither Susan nor Glen is particularly interested in acquiring a bigger stake in the firm, but they do not want to see stock sold to individuals outside the firm. Susan’s daughter has no interest in the firm.

**SUSAN’S PERSONAL AND FINANCIAL GOALS**

- Leave the company within five years and maintain her desired level of income and lifestyle
- Establish an exit strategy for the business
- Ensure that her mother, Maude, has adequate income, possibly through the acquisition of her mother’s stock in the company
- Evaluate both investment and insurance risk
- Spend $50,000 on the purchase of new bedroom and living room furniture for her home

**ECONOMIC INFORMATION**

- Susan expects inflation to average 3.5% annually, both currently and for the long term.
- She expects her salary to increase 10% annually.
- Interest rates are very low and expected to rise in the near future.
- Stocks are expected to appreciate 9.5% annually.

**INCOME TAX INFORMATION**

Her marginal income tax rate is currently 35% for federal income taxes. The state income tax rate is a flat 5%.

**RETIREMENT INFORMATION**

Susan plans to retire in five years at age 55. She would like to have a standard of living that can be provided by 80% of her preretirement income. She expects to be in retirement for 35 years.

The company implemented a profit-sharing plan several years ago. Last year, the company contributed 15% of each eligible employee’s salary to the plan. The plan initially incorporated a five-year cliff vesting schedule, and employees were eligible to participate after completing one year of service. The plan offers loan provisions, subject to the Tax Code limits. Susan’s account has a current balance of $350,000.

Susan expects to collect $24,000 per year in Social Security benefits at her full retirement age. She has been considering the possibility of receiving her Social Security benefits at age 62.
**DIVORCE INFORMATION**

Susan and her ex-husband, Mark, were divorced two years ago. Mark works in the marketing department of a Fortune 500 company, and his salary is $75,000. Pursuant to the divorce arrangement, Susan is required to pay Mark alimony in the amount of $45,000 each year for the next seven years. If Susan dies during the next seven years, payments must be made from her estate.

Susan and Mark purchased a house several years ago for $280,000. They owned the house as JTWROS until the divorce. Per the divorce agreement, the house was titled solely in Mark’s name. The value of the house at the time of the divorce was $350,000, and today’s value of the house is $375,000.

Susan was also required to transfer her $800,000 whole life insurance policy to Mark pursuant to the divorce agreement. The cash value of the policy is currently $40,000, and the divorce agreement requires Susan to pay the annual $10,000 premium as alimony.

**GIFTS, ESTATES, TRUSTS, AND WILL INFORMATION**

**Gifts**

Susan has made no taxable gifts.

**Estates**

Susan’s will leaves everything to her ex-husband, Mark. She has not updated the will since the divorce.
# Statement of Cash Flows

**Susan Wood**  
**January 1–December 31, 2018**

## CASH INFLOWS

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary</td>
<td>$250,000</td>
</tr>
<tr>
<td>Bonus</td>
<td>$100,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$350,000</strong></td>
</tr>
<tr>
<td>Unearned income</td>
<td></td>
</tr>
<tr>
<td>Dividends</td>
<td>$2,000</td>
</tr>
<tr>
<td>Interest income</td>
<td>$10,000</td>
</tr>
<tr>
<td><strong>Total inflows</strong></td>
<td><strong>$350,000</strong></td>
</tr>
</tbody>
</table>

## CASH OUTFLOWS

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mortgage payments, primary residence</td>
<td>$50,000</td>
</tr>
<tr>
<td>Insurance premiums</td>
<td></td>
</tr>
<tr>
<td>Homeowners</td>
<td>$2,500</td>
</tr>
<tr>
<td>Auto</td>
<td>$3,000</td>
</tr>
<tr>
<td>Life (policy owned by ex-spouse)</td>
<td>$10,000</td>
</tr>
<tr>
<td><strong>Total insurance premiums</strong></td>
<td><strong>$15,500</strong></td>
</tr>
<tr>
<td>Miscellaneous expenses</td>
<td></td>
</tr>
<tr>
<td>Alimony</td>
<td>$45,000</td>
</tr>
<tr>
<td>Entertainment</td>
<td>$20,000</td>
</tr>
<tr>
<td>Food</td>
<td>$8,400</td>
</tr>
<tr>
<td>Clothes</td>
<td>$15,000</td>
</tr>
<tr>
<td>Utilities</td>
<td>$10,000</td>
</tr>
<tr>
<td>Charity</td>
<td>$20,000</td>
</tr>
<tr>
<td><strong>Total miscellaneous expenses</strong></td>
<td><strong>$118,400</strong></td>
</tr>
<tr>
<td>Taxes</td>
<td></td>
</tr>
<tr>
<td>Property</td>
<td>$ 35,000</td>
</tr>
<tr>
<td>Federal and state income taxes and FICA</td>
<td>$135,000</td>
</tr>
<tr>
<td><strong>Total taxes</strong></td>
<td><strong>$170,000</strong></td>
</tr>
</tbody>
</table>

## Total inflows $362,000

## Total outflows $353,900

Net cash flow (surplus) $8,100
## Statement of Financial Position

**Susan Wood**  
**As of December 31, 2018**

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>LIABILITIES AND NET WORTH</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash/cash equivalents</strong></td>
<td><strong>Liabilities</strong></td>
</tr>
<tr>
<td>S Savings account</td>
<td>$8,000</td>
</tr>
<tr>
<td>S Cash value of universal life policy</td>
<td>20,000</td>
</tr>
<tr>
<td>M Cash value of whole life policy</td>
<td>40,000</td>
</tr>
<tr>
<td><strong>Total cash/cash equivalent</strong></td>
<td><strong>$68,000</strong></td>
</tr>
<tr>
<td><strong>Invested assets</strong></td>
<td><strong>Long-term liabilities</strong></td>
</tr>
<tr>
<td>S EastWood stock</td>
<td>$1,800,000</td>
</tr>
<tr>
<td>S Profit-sharing plan</td>
<td>350,000</td>
</tr>
<tr>
<td>S Investment portfolio</td>
<td>900,000</td>
</tr>
<tr>
<td><strong>Total investments</strong></td>
<td><strong>$3,050,000</strong></td>
</tr>
<tr>
<td><strong>Personal-use assets</strong></td>
<td><strong>Net worth</strong></td>
</tr>
<tr>
<td>S Primary residence</td>
<td>$750,000</td>
</tr>
<tr>
<td>S Personal property/furniture</td>
<td>200,000</td>
</tr>
<tr>
<td>S Luxury car</td>
<td>85,000</td>
</tr>
<tr>
<td>S SUV</td>
<td>50,000</td>
</tr>
<tr>
<td><strong>Total personal use</strong></td>
<td><strong>$1,085,000</strong></td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>$4,203,000</strong></td>
</tr>
</tbody>
</table>

Notes to financial statements:

1. Assets are stated at fair market value (rounded to even dollars).
2. Liabilities are stated at principal only (rounded to even dollars).
3. The auto loan was used for the purchase of a car by Audrey. Susan is a cosigner on the loan.

**Property ownership:**

- S—Susan's property
- M—Mark's property
- A—Audrey's property
INSURANCE INFORMATION

**Life Insurance**

<table>
<thead>
<tr>
<th>Description</th>
<th>Universal life</th>
<th>Whole life</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insured</td>
<td>Glen</td>
<td>Susan</td>
</tr>
<tr>
<td>Face amount</td>
<td>$500,000</td>
<td>$800,000</td>
</tr>
<tr>
<td>Cash value</td>
<td>$20,000</td>
<td>$40,000</td>
</tr>
<tr>
<td>Annual premium</td>
<td>$6,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>Premium payer</td>
<td>Glen</td>
<td>Susan</td>
</tr>
<tr>
<td>Beneficiary</td>
<td>Susan</td>
<td>Mark</td>
</tr>
<tr>
<td>Policyowner</td>
<td>Susan</td>
<td>Mark</td>
</tr>
<tr>
<td>Comments</td>
<td>Susan is a revocable beneficiary.</td>
<td>Policy was transferred to Mark pursuant to the divorce.</td>
</tr>
</tbody>
</table>

**Health Insurance**

Susan is covered by the company's health plan, which is an indemnity plan with a $1,000 deductible per person per year and an 80/20 coinsurance clause.

**Long-Term Disability Insurance**

Susan is covered by an own-occupation policy with premiums paid by the company. The benefits equal 60% of gross income after a 180-day elimination period. The policy covers both sickness and accidents.

INVESTMENT INFORMATION

**Detailed Investment Portfolio**

<table>
<thead>
<tr>
<th>Description</th>
<th>Expected return</th>
<th>Current FMV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable zero-coupon bonds</td>
<td>7%</td>
<td>$200,000</td>
</tr>
<tr>
<td>Zero-coupon municipal bond fund</td>
<td>6%</td>
<td>$300,000</td>
</tr>
<tr>
<td>Long-term municipal bond fund</td>
<td>5%</td>
<td>$200,000</td>
</tr>
<tr>
<td>International stocks</td>
<td>10%</td>
<td>$10,000</td>
</tr>
<tr>
<td>Precious metals mutual fund</td>
<td>4%</td>
<td>$90,000</td>
</tr>
<tr>
<td>Treasury bills</td>
<td>2%</td>
<td>$100,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>$900,000</strong></td>
</tr>
</tbody>
</table>

Susan is willing to take reasonable investment risk if appropriate, but she does not want to invest aggressively.

She is interested in investing in equity securities. She was recently told by a broker that Rett Manufacturing Company stock would be a wise purchase. The stock is currently trading at $45 per share and pays a dividend of $2 per share, with an estimated 4% annual dividend growth rate. The stock has a beta of 1.04.
Questions

1. Susan has told you that Maude wants to divest herself of her interest in EastWood. Because this could affect Susan’s financial planning, she has asked you what various ways Maude could transfer her interest in the business to Susan and Glen while satisfying her need for income and greater liquidity. Susan wants to assist her mother while also understanding the impact on her own retirement plans. These alternatives could include all the following EXCEPT
   A. a private annuity
   B. an installment sale
   C. an outright gift
   D. company stock redemption

2. Assume that upon your recommendation Susan and Glen implement a private annuity to purchase Maude’s business interest. They engage you to monitor the performance of the recommendation and to alert them if any modifications become advisable because of changed circumstances. Which of the following actions would be appropriate in the performance of your monitoring activities?
   1. Once Maude has lived to her full actuarial life expectancy, advise Susan and Glen that they can cease making payments.
   2. When Maude dies, advise Susan and Glen that they can cease making payments.
   3. If Maude ever feels insecure about their ability to make the payments, advise Susan and Glen that they must provide collateral.
   4. If Maude dies, advise Susan and Glen that they receive a stepped-up basis in the business interest.
   A. 2 only
   B. 1 and 4
   C. 3 and 4
   D. 1, 2, and 3

3. Glen is considering converting the business to an S corporation when Susan retires. If this conversion takes place, EastWood may be subject to all of the following EXCEPT
   A. built-in gains tax
   B. LIFO recapture tax
   C. excess net passive income tax
   D. depreciation recapture tax

4. Glen is willing to consider a 10- or 15-year installment sale, but only if Susan will also participate in the purchase of Maude’s stock. Is an installment purchase appropriate for Susan’s situation?
   A. Yes. It allows her to purchase the stock in small amounts over time.
   B. No. The time frame of the purchase falls within Susan’s planned retirement time horizon.
   C. Yes. It allows her to maintain an ownership percentage equal to Glen’s.
   D. No. Susan may not be able to fully deduct the interest expense associated with the purchase.
5. What type of plan benefits could EastWood establish that not only would provide a means for Maude to liquidate her stock but eventually could be used to help Susan and Glen liquidate their own holdings?

A. Restricted stock plan  
B. ESOP  
C. Section 412(e)(3) plan  
D. Corporate-owned life insurance (COLI)

6. Glen and Susan have agreed to implement a cross-purchase buy-sell agreement between the two of them in the event of death or disability. They have chosen not to implement one between them and Maude. Which of the following statements regarding the buy-sell agreement is CORRECT?

A. Maude could be included in the buy-sell agreement only if she were an active participant in the business.  
B. Life insurance premiums will be deductible by the corporation because the S corporation election was not made.  
C. The cost to insure Maude's life would be significantly more expensive if she were included in the buy-sell agreement.  
D. Provisions in Maude's will could bind Susan and Glen to purchase her shares upon her death.

7. Which of the following items listed on Susan's statement of financial position are examples of tangible personal property?

1. Primary residence  
2. Luxury car  
3. Savings account  
4. Personal property/furniture  

A. 1 and 2  
B. 2 and 4  
C. 1, 2, and 4  
D. 2, 3, and 4

8. Susan's daughter is married to a wealthy businessman and is financially secure. Susan would prefer that the bulk of her estate go to her grandson after she dies, but she does not want to give up control over her property while she is alive. Which of the following would be the best technique to accomplish her goal?

A. Make annual gifts to her grandson that do not exceed the annual exclusion amount  
B. Leave assets to the grandson in her will  
C. Title her assets as JTWROS with her grandson  
D. Give her grandson a power of attorney over her property
9. Susan would like to help fund the college education costs for her grandson. Assuming she does not want to give up control of the assets and wants tax deferral, which of the following would be an appropriate vehicle to consider?

A. Section 2503(b) trust  
B. Roth IRA  
C. UGMA  
D. Section 529 plan

10. Which of the following investments would be appropriate to diversify Susan’s investment portfolio?

1. Zero-coupon municipal bond fund  
2. International stocks  
3. S&P 500 Index fund  
4. Leveraged commercial real estate

A. 1 and 4  
B. 2 and 3  
C. 2, 3, and 4  
D. 1, 2, 3, and 4

11. Assume Susan has retained you to monitor the performance of her investment portfolio. If the economic expectations outlined in this case regarding interest rates are accurate, which of the following strategies would you recommend for Susan?

A. Sell the Treasury bills  
B. Buy convertible bonds  
C. Sell the long-term municipal bond fund  
D. Buy intermediate-term bonds

12. Assuming that Susan has a required rate of return of 7%, would the purchase of Rett Manufacturing Company stock be advisable for her portfolio?

A. Yes, because the stock is undervalued  
B. No, because the stock is overvalued  
C. Yes, because the required rate of return is greater than the expected growth rate  
D. No, because the stock is not within her risk tolerance

13. Which of the following benefits could EastWood install on a discriminatory basis without adverse tax consequences for covered individuals?

1. A group term life insurance plan that provides up to $50,000 of coverage  
2. A supplemental executive retirement plan (SERP)  
3. Section 125 cafeteria plan

A. 1, 2, and 3  
B. 1 and 3  
C. 2 only  
D. 3 only
14. If Susan and Glen entered into a stock redemption buy-sell agreement with EastWood, which of the following would be a disadvantage?

A. A transfer-for-value problem could occur if either Susan or Glen transfers a life insurance policy to EastWood to fund the agreement.
B. More policies will be required with a stock-redemption agreement than with a cross-purchase agreement.
C. The owner who survives will be required to come up with sufficient cash to purchase the interest of the deceased owner.
D. The insurance proceeds to EastWood upon the death of Susan or Glen could be subject to income taxation.

15. Maude is covered by Medicare Parts A and B. Which of the following expenses is NOT covered under Medicare?

A. Hospice costs for terminally ill patients
B. Mammograms
C. Annual flu shots
D. Coverage for long-term custodial care

16. Marvin, a long-time employee at EastWood Architectural, resigned during the year to pursue other opportunities. How many months of medical insurance COBRA continuation coverage will be available to Marvin?

A. 0 months
B. 18 months
C. 29 months
D. 36 months

17. Per the divorce agreement, Susan and Mark's house was transferred to Mark. Which of the following statements regarding the income tax consequences of the transfer is CORRECT?

A. Because the transfer occurred after the couple was no longer married, a gift occurred from Susan to Mark.
B. Mark will have a basis in the home of $280,000.
C. Mark's basis in the home will be increased by gift tax paid upon the transfer.
D. Mark will have a basis in the home of $350,000.
18. Which of the following statements regarding the whole life insurance policy on Susan’s life is(are) CORRECT?

1. If Susan died today, the entire $800,000 death benefit would be included in her probate estate.
2. The cash value of the policy, less the annual exclusion, was considered a taxable gift from Susan to Mark.
3. Susan is entitled to an income tax deduction for the premiums paid on the life insurance policy.
4. A transfer of a life insurance policy pursuant to a divorce agreement is considered a transfer for value for income tax purposes; therefore, the death benefit will be taxable to Mark when Susan dies.

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

19. Which of the following statements regarding Susan’s financial statements are CORRECT?

I. Susan should not include the whole life insurance policy on her statement of financial position.
II. If Susan purchases new bedroom and living room furniture for her home, this purchase would appear as a variable outflow on her cash flow statement.

A. I only
B. II only
C. Both I and II
D. Neither I nor II

20. Susan has inquired about the possibility of taking a loan from the profit-sharing plan to pay some general expenses. Which of the following statements regarding loans from qualified plans is CORRECT?

A. Because the plan is a Keogh plan, loans to Susan, a business owner, will be limited to 20% of her gross salary.
B. The interest paid on the loan will be deductible for income tax purposes to the extent Susan has taxable investment income.
C. Susan is not permitted to take a loan from the plan because she is a more than 10% owner.
D. The maximum loan Susan can take from the plan is $50,000.
21. Glen and Susan use the same CFP® professional for financial planning advice. Maude, however, does not have a financial planner, believing it is too late in her life to engage one. The siblings approach you, their CFP® professional, and tell you they will be bringing in Maude for financial planning services, especially her ongoing retirement planning and estate planning so they can be assured they know what is happening with their mother financially, assuming you will keep them informed. Which of the following actions can you do while remaining in compliance with CFP® Board’s Code of Ethics?

1. You can disclose the details of Maude’s financial status to Glen and Susan because they are members of Maude’s immediate family.
2. You can disclose the details of Maude’s financial status to Glen and Susan only if the siblings benefit from her will.
3. You can disclose the details of Maude’s financial status to Glen and Susan with Maude’s authorization.
4. You can disclose the details of Maude’s financial status if the records are subpoenaed for a court proceeding.

A. 1 and 3
B. 3 and 4
C. 1, 2, and 3
D. 2, 3, and 4
**ANSWER SUMMARY**

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

**SUMMARY OF TOPICS**

1. Estates—Business Continuation
2. Estates—Private Annuity
3. Tax—Taxation of Business Entities
4. Estates—Business Succession Planning
5. Retirement—Qualified Plans
6. Estates—Buy-Sell Agreement
7. Fundamentals—Financial Statements
8. Estates—Gifting Techniques
9. Fundamentals—Education Funding
10. Investments—Diversification
11. Investments—Portfolio Management
12. Investments—Constant Growth Dividend Discount Model
13. Insurance—Employee Benefits
14. Estates—Buy-Sell Agreement
15. Insurance—Medicare
16. Insurance—COBRA
17. Tax—Property Transfer
18. Tax—Life Insurance
19. Fundamentals—Financial Statements
20. Retirement—Qualified Plan Rules
Solutions

**Estates—Business Continuation**
1. C
   Susan and Glen could purchase Maude’s interest in EastWood using either a private annuity or an installment sale, or EastWood could repurchase Maude’s stock in the company. Each would affect Susan’s retirement planning, and further scenario analysis would be needed by Susan’s CFP® professional to develop a recommendation on which would satisfy Susan’s needs and also her mother’s. An outright gift of her business interest would not satisfy Maude’s desire for income or need for greater liquidity.

**Estates—Private Annuity**
2. A
   Statement 1 is incorrect. Payments under a private annuity continue for as long as the seller lives, even if that is longer than her actuarial life expectancy.
   Statement 2 is correct.
   Statement 3 is incorrect. A private annuity cannot be secured by collateral.
   Statement is incorrect. The buyers under a private annuity do not receive a stepped-up basis when the seller dies. Their basis is the total amount of the payments made under the annuity.

**Tax—Taxation of Business Entities**
3. D
   S corporations may be subject to built-in gains tax, LIFO recapture tax, and excess net passive income tax if they were previously C corporations.

**Estates—Business Succession Planning**
4. B
   Susan is planning on retiring in five years. Therefore, a 10- to 15-year payable installment note is not the best choice. All the stock is purchased at one time. Only the payments are made over time. Susan wishes to retire soon. Interest expense is deductible in installment sales.

**Retirement—Qualified Plans**
5. B
   A restricted stock plan would provide more shares to the owners. This plan would not help in the liquidation of the owners’ interests.
   An employee stock ownership plan (ESOP) may be appropriate. This plan, which is a qualified plan, could purchase the stock from the shareholders. ESOPs have other tax advantages as well.
   A Section 412(e)(3) plan is a defined benefit plan that is funded with life insurance. COLI is a good planning strategy but will not solve their liquidation goals.
Estates—Buy-Sell Agreement
6. C
Maude is older; therefore, premiums on a life insurance policy on her life would be more expensive. 
Buy-sell agreements are not limited to active participants. The premiums are not deductible. Maude's 
will cannot require Susan and Glen to purchase her shares.

Fundamentals—Financial Statements
7. B
Tangible personal property is personal property that is moveable and subject to physical possession, 
such as furniture and automobiles. Structures on land, such as a residence, are real property. A savings 
account is an example of intangible personal property.

Estates—Gifting Techniques
8. B
Although most of the strategies have merit, Susan should leave the property to her grandson in her will. 
All the other choices involve giving up some current control over the assets.

Fundamentals—Education Funding
9. D
A Section 2503(b) trust would cause Susan to give up control of the assets and does not provide tax 
deferral.
Susan does not qualify for a Roth IRA because of her income.
An UGMA account would cause Susan to give up control of the assets and does not provide tax 
deferral.
A Section 529 plan is the best choice for Susan. A college savings plan can permit the contributor 
to select among different investment strategies designed exclusively for the program when the initial 
contribution is made to establish the account.

Investments—Diversification
10. B
Investment options 2 and 3 would provide additional diversification because Susan has relatively no 
equity exposure in her portfolio other than the stock in the closely held company.
Investment option 1 is incorrect. The municipal bond fund would not provide the needed growth 
component.
Investment option 4 is incorrect. Leveraged commercial real estate is outside her risk tolerance.

Investments—Portfolio Management
11. C
When interest rates are expected to rise, an investor should sell long-term bonds and reinvest the 
proceeds at a future higher coupon rate.
Investments—Constant Growth Dividend Discount Model

12. A

The formula for finding the value of a stock using this model is as follows:

\[ V = \frac{D_1}{r - g} \]

- \( V \) = the intrinsic value of the stock
- \( D_1 \) = the dividend paid at the end of period 1
- \( r \) = the investor's required rate of return
- \( g \) = the dividend growth rate

Intrinsic value = \[ \$2 \times (1.00 + 0.04) \div (0.07 - 0.04) = $69.33 \]

The stock is undervalued at $45 per share.

Insurance—Employee Benefits

13. C

Statement 1 is incorrect. If a group term life insurance plan is discriminatory, the key employees will lose the $50,000 income tax exclusion.

Statement 2 is correct. A SERP is a nonqualified plan and can be discriminatory.

Statement 3 is incorrect. If a cafeteria plan is discriminatory, key employees will have adverse tax consequences.

Estates—Buy-Sell Agreement

14. D

A transfer of a life insurance policy from a shareholder to a corporation will not be considered a transfer for value.

A cross-purchase agreement will typically require the purchase of more policies.

Under a stock redemption buy-sell agreement, the corporation (not the surviving owner) buys the shares of a deceased owner.

Life insurance proceeds received by a corporation may be subject to corporate alternative minimum tax.

Insurance—Medicare

15. D

Custodial care is not covered under Medicare.

Insurance—COBRA

16. A

COBRA coverage applies only to employers with 20 or more employees.

Tax—Property Transfer

17. B

When a spouse receives property pursuant to a divorce, the basis in the property will always be carryover basis from the transferor spouse.
**Tax—Life Insurance**

18. **A**

Statement 1 is incorrect. The death benefit is not included in Susan’s probate estate because Susan is not the owner of the policy and the proceeds are not payable to her estate.

Statement 2 is incorrect. A transfer of a life insurance policy pursuant to a divorce is not subject to gift tax.

Statement 3 is correct. Susan transferred ownership of the policy and she is required to pay premiums on the life insurance policy, so the premium payments will be considered deductible alimony. Note that Mark will be required to include the amount of the premium payments in his gross income.

Statement 4 is incorrect. Transfers incident to a divorce are not subject to the transfer-for-value rule.

**Fundamentals—Financial Statements**

19. **C**

Both statements I and II are correct. Statement I is correct because Susan is not the owner of the policy. Statement II is correct because this purchase is a variable outflow. This purchase would also appear as a personal-use asset on her net worth statement.

**Retirement—Qualified Plan Rules**

20. **D**

The plan is not a Keogh plan because the company is a C Corporation. In addition, there is no such rule for loans.

Interest on loans for other than the acquisition of a principal residence from qualified plans is considered personal interest and is not deductible for income tax purposes.

Although there previously were restrictions on loans for businessowners, those restrictions have been eliminated. The previous restrictions applied only to Keogh plans.

The maximum loan that can be taken from a profit-sharing plan is $50,000.

**Fundamentals—Code of Ethics**

21. **B**

Statement 3 is correct. The Code of Ethics’ Principle 5—Confidentiality requires certificants to ensure that clients’ information is accessible only to those authorized to have access. Statement 4 is also correct. Rule of Conduct 3.1 compels certificants to treat information as confidential except as required in response to proper legal process, as necessitated by obligations to a certificant’s employer or partners, to defend against charges of wrongdoing; in connection with a civil dispute; or as needed to perform the services.