

Discussion Guide
November 2016

Tax Efficiency of Mutual Funds and Exchange-Traded Funds

1. All of the following statements regarding the placement of an investment in a taxable or tax-sheltered account are correct EXCEPT:

A. As a general rule, according to Michael Kitces, high-yield bond funds with higher expected returns are likely to benefit most from being placed in a tax-sheltered account.

B. Kitces cites an S&P 500 index fund as an example of an investment with a high degree of relative tax efficiency that should likely be placed in the taxable account.

C. As a general rule, according to Michael Kitces, high-trading investment funds are likely to benefit most from being placed in a tax-sheltered account.

D. According to Kitces, if the investor has a 30-year investment horizon and a 25 percent marginal income tax rate, stocks that have a 2.50 percent dividend rate and are turned over infrequently should be held in a taxable account.

2. Which statement(s) about tax cost ratio is (are) correct?

I. Tax cost ratio is roughly the difference between the pretax and after-tax return where higher levels indicate a greater degree of tax inefficiency.

II. In the article, "In Search of Tax Efficiency," Alex Bryan cites tax cost ratio as an accurate assessment of tax efficiency.

A. I only

C. Both I and II

B. II only

D. Neither I nor II

3. All of the following statements regarding master limited partnerships (MLPs) are correct EXCEPT:

A. Distributions from an MLP ETF are generally considered to be qualified dividends.

B. David Kwon encourages caution when considering a direct investment in an MLP if the investor plans to place the investment in a tax-sheltered account because of the potential for unrelated business taxable income.

C. Distributions from an MLP ETF are considered to be ordinary income.

D. An indirect investment in an MLP has the disadvantage of requiring the need to deal with filing a Schedule K-1.

Intergenerational Split Dollar—Just What Has the Tax Court Approved?

4. All of the following statements about the *Morrisette* case are correct EXCEPT:

A. In *Morrisette*, the Tax Court approved an intergenerational split-dollar arrangement.

B. Mrs. Morrisette paid lump-sum premiums of \$29.9 million for dynasty trusts to purchase universal life insurance policies.

C. Mrs. Morrisette's estate valued her rights under the split-dollar arrangements at the total dollar amount in premiums she had paid for policies on the lives of her children.

D. The Tax Court in *Morrisette* held that the technical requirements in the regulations for applying the split-dollar economic benefit regime were satisfied.

5. All of the following statements about split-dollar life insurance are correct EXCEPT:

A. In 1964, the IRS began taxing the death benefit portion of the life insurance policy as an economic benefit pursuant to Revenue Ruling 64-328.

B. Notice 2002-8 provided transitional rules for the treatment of split-dollar arrangements entered into before December 31, 2003.

C. In an endorsement split-dollar arrangement, typically the employer or a senior family member owns the life insurance policy and endorses some of the death benefits to employees or junior family members.

D. In a collateral assignment split-dollar arrangement, typically the employee or junior family member owns the life insurance policy and assigns an interest back to the employer or senior family member.

6. All of the following statements about Notice 2002-8 are correct EXCEPT:

A. Notice 2002-8 addressed valuation issues.

B. Notice 2002-8 provided certain safe harbors for avoiding tax on the transfer of the equity element of split-dollar policies.

C. Notice 2002-8 provided for the use of Table 2001 for determining the current value of life insurance coverage.

D. Notice 2002-8 eliminated the availability of the insurer's one-year term rate for valuing life insurance coverage in split-dollar arrangements.

7. All of the following statements about intergenerational split-dollar arrangements are correct EXCEPT:

- A. Intergenerational split-dollar arrangements were first introduced by the IRS in Notice 2015-17.
- B. Under intergenerational split-dollar arrangements, a parent pays premiums insuring a child or grandchild's life.
- C. Under intergenerational split-dollar arrangements, premium advances are repaid after the insured's death.
- D. Substantial discounts may apply in determining the present value of a parent's reimbursement right in an intergenerational split-dollar arrangement.

Understanding Distributions of Life Insurance from a Business to an Owner

8. All of the following statements describe possible approaches for the transfer of a life insurance policy from a business to a business owner EXCEPT:

- A. The value of the policy can be treated as compensation to the business owner.
- B. The policy can be sold for its fair market value to the business owner.
- C. The value of the policy can be treated as a dividend or shareholder distribution to the business owner.
- D. The business could make an IRC Section 1035 exchange.

9. Assume a business owns an insurance policy with a fair market value of \$250,000 on one of its owner-employees. The parties agree to transfer the policy to the owner and treat the value of the policy as compensation. What will be the owner's basis in the insurance contract immediately after the transfer?

- A. \$250,000
- B. The same as the company's basis.
- C. \$0
- D. \$250,000 minus the business owner's current salary.

10. Laura and her three adult children each have equal ownership in an S corporation. The corporation owns a life insurance policy on Laura with a fair market value of \$250,000 and decides to transfer the policy to Laura. Which statement(s) about the transaction is (are) correct?

I. Since distributions in an S corporation must be allocated proportionately to each shareholder based on his or her ownership, if the policy is transferred to Laura, each of the other owners must receive cash or property worth \$250,000 as well.

II. The S corporation will receive an income tax deduction for any shareholder distributions to Laura and her children.

- A. I only
- B. II only

- C. Both I and II
- D. Neither I nor II

11. All of the following statements regarding tax consequences related to the distribution of a life insurance policy to a business owner as part of the sale proceeds of the business are correct EXCEPT:

A. The general rule for a sale or total redemption of a business owner's interest is that the proceeds received include the owner's basis, which is received income tax free, and any gain, which is subject to capital gains tax.

B. If the business is a C corporation, the redemption proceeds, including the value of the life insurance policy, will be received by the owner tax free.

C. In a family-owned business, attribution of ownership can result in certain payments being treated as dividends instead of a capital transaction.

D. If the business is a partnership, a liquidating distribution that includes appreciated property, such as a life insurance policy, does not trigger recognition of gain to the partnership.

Spousal Rollovers

12. From a tax-deferred growth perspective, who is generally the best beneficiary of a retirement account?

- A. Grantor trust
- B. IRA owner's spouse
- C. IRA owner's estate
- D. IRA owner's children

13. All of the following statements about treatment of a decedent's IRA as an inherited IRA are correct EXCEPT:

A. If a widow elects to treat her deceased husband's IRA as an inherited IRA, the IRA remains in the name of the deceased spouse for the benefit of the surviving spouse.

B. If a widow elects to treat her deceased husband's IRA as an inherited IRA, required minimum distributions must be calculated using the Single Life Table based on the widow's age in each given year.

C. If a widow elects to treat her deceased husband's IRA as an inherited IRA, she does not have to begin taking required minimum distributions until the deceased husband would have turned age 70½.

D. If a widow elects to treat her deceased husband's IRA as an inherited IRA, the IRA must be fully distributed within 12 years of the decedent's death.

14. All of the following statements regarding a spousal rollover of a decedent's IRA are correct EXCEPT:

A. When the surviving spouse chooses a rollover option, he or she becomes the owner of the IRA for all purposes.

B. If the IRA owner dies prior to age 62, the surviving spouse is deemed to have performed a spousal rollover.

C. If the surviving spouse makes an addition to the decedent's IRA, he or she is deemed to have performed a spousal rollover.

D. If the surviving spouse fails to take a required minimum distribution as a beneficiary of the deceased spouse's IRA, he or she is deemed to have performed a spousal rollover.

15. Which statement(s) about the "on the account of death" exception to the 10 percent early distribution penalty is (are) correct?

I. Courts have held that a beneficiary loses the ability to claim the "on account of death" exception to the 10 percent early distribution penalty if the beneficiary rolls over the funds from the deceased spouse's IRA into his or her own IRA and thereafter withdraws funds.

II. In *Gee v. Commissioner*, the court held that when a beneficiary rolls over funds from the deceased's spouse's IRA, the funds become the beneficiary's own, and any subsequent distributions are no longer on account of the death of the spouse.

A. I only

C. Both I and II

B. II only

D. Neither I nor II

16. All of the following statements about a spousal rollover through a trust or estate are correct EXCEPT:

A. As a general rule, if IRA proceeds pass through an estate and then are distributed to the surviving spouse, a rollover is not allowed.

B. In PLR 201618011, the IRS allowed a spousal rollover because no third party could prevent the surviving spouse from receiving the proceeds of the IRA.

C. In PLR 201523010, the IRS denied a spousal rollover when the retirement account was payable to a trust in which the surviving spouse was the sole trustee.

D. A key factor in cases where a spousal rollover is sought is the unilateral ability of the surviving spouse to control the disposition of the IRA.

A New Era in Client Communications after the Fiduciary Rule

17. Which statement(s) about the Vanguard Group and Spectrem Group survey of ultra-high-net-worth households is (are) correct?

I. The survey found that clients were most likely to leave their financial advisor because of poor communication.

II. Sixty-seven percent of those surveyed indicated that not having calls returned promptly was their major reason for leaving their financial advisor.

A. I only

C. Both I and II

B. II only

D. Neither I nor II

18. All of the following statements about client communication are correct EXCEPT:

A. To ensure a successful practice, an advisor needs to align technology with his or her goals and use it to address core business challenges.

B. To remain effective, client communications must include traditional components such as cards for birthdays and anniversaries.

C. In determining the appropriate means of communication with clients, generational differences must be considered.

D. A video call with a client and his or her other advisors is a powerful example of using technology to best serve a client.

19. When does the Department of Labor's fiduciary rule become effective?

A. January 1, 2017

B. April 10, 2016

C. January 1, 2018

D. April 10, 2017

20. All of the following statements about the Department of Labor (DOL) fiduciary rule are correct EXCEPT:

- A. It is regarded as a consumer protection measure.
- B. The rule makes changes to the Employee Retirement Income Security Act of 1974.
- C. Under the rule, the definition of a fiduciary is any individual receiving compensation for providing advice that is individualized or especially directed to a specific plan sponsor, plan participant, or owner of an IRA for consideration in making a retirement investment decision.
- D. The new Department of Labor (DOL) fiduciary rule excludes registered investment advisors but includes insurance agents, brokers, and any other type of financial advisor.

21. All of the following statements about whether a communication constitutes advice versus education under the DOL fiduciary rule are correct EXCEPT:

- A. Communications from plan sponsors or service providers will always constitute advice.
- B. A communication is not considered advice if it does not meet the definition of a recommendation.
- C. A communication is more likely to be considered a recommendation/advice if it is designed specifically for an individual.
- D. For retirement plans, use of tools such as asset allocation models or interactive investment information is not considered advice.

22. In which of the following situations would the advisor be considered to be acting as a fiduciary?

- A. The advisor sends out a quarterly newsletter to his clients about pending tax law changes.
- B. The advisor sends out a quarterly newsletter to his clients about the short- and long-term economic outlook.
- C. The advisor makes a presentation at a conference and discusses features of an improved client Web site.
- D. An advisor suggests to an IRA client that she make changes in investments due to an underperforming fund.

23. All of the following statements about event-driven communication are correct EXCEPT:

- A. It is in the client's best interest.
- B. It is more efficient than the old ways and can increase an advisor's book of business.
- C. It is typically more expensive than more traditional client communication.
- D. Event-driven communication assists in an advisor's branding message.

24. Which statement(s) about the core functions of a client relationship management (CRM) system is (are) correct?

- I. An important aspect of using a CRM system is that it can compile information from many different sources.
 - II. A CRM serves a business process automation function that can provide calendars, templates, and task lists.
- A. I only
 - B. II only
 - C. Both I and II
 - D. Neither I nor II

25. All of the following identify next actions to prepare for implementation of the Department of Labor (DOL) fiduciary rule EXCEPT:

- A. Identify gaps in communication procedures that prevent being in full compliance with the DOL rule.
- B. Register with the DOL as a fiduciary.
- C. Analyze the book of business to determine which clients should receive appropriate levels of communication and the methods best suited to that segment.
- D. Use technology to the fullest extent to meet the complex needs of clients, and increase efficiency and productivity.

Comparing Fixed-Rate Mortgage Loans with Horizon-Specific Loan Payoff Schedules and Identical Net Loan Amounts

26. All of the following statements about TILA and RESPA Integrated Disclosure (TRID) are correct EXCEPT:

- A. TRID was created under the Dodd-Frank Act and went into effect on October 3, 2010.
- B. TRID combines the mortgage and loan disclosures required under the Truth in Lending Act and the Real Estate Settlement Procedures Act.
- C. TRID requirements are intended to increase transparency and accuracy about the real cost of a

loan.

D. TRID requirements are designed to allow for easier loan comparisons.

27. What is the life span of a mortgage in the United States?

A. The U.S. Census Bureau reports that it is seeing an average life span of 7.5 years.

B. A 2006 Freddie Mac report indicated that since 1999 homes have been refinanced an average of every 5 years.

C. 8 years

D. In an article in *Mortgage News Daily*, Jann Swanson reports the age of existing mortgage loans is 60 months.

28. All of the following statement(s) about mortgage rate comparisons as illustrated in Tables 1, 2, and 3 are correct EXCEPT:

A. Table 2 illustrates that when the mortgage is carried to term, the loan with the lowest APR is preferable.

B. Table 1 illustrates that over a 15-year payment period, the loan with the 6.25 percent rate of interest is preferable.

C. Table 3 illustrates that with change in the time horizon for holding the mortgage to a more realistic 5-year period, the loan with highest monthly payment is preferable.

D. Loans with higher closing costs will be less preferable with a shorter holding period for the mortgage.

29. Which statement(s) about mortgage loan comparisons is (are) correct?

I. Given specific circumstances, knowing the closing cost is the best comparator to use in choosing a mortgage.

II. Using a borrower's specific time horizon and identical loan amounts produces loan comparisons that are conceptually more correct, realistic, accurate, and helpful to the consumer.

A. I only

C. Both I and II

B. II only

D. Neither I nor II

The State of a Trust's Situs

30. All of the following statements about the situs of a trust are correct EXCEPT:

- A. The location of a trust's situs can affect its administrative efficiency and taxes.
- B. During the lifetime of a trust, situs can possibly be claimed by multiple jurisdictions.
- C. A trust can never have more than one official situs.
- D. Factors such as the settlor's domicile and the current residence of trust beneficiaries can affect determination of the trust situs.

31. All of the following identify a type of trust situs EXCEPT:

- A. Administrative situs
- B. Tax situs
- C. Settlor situs
- D. Jurisdictional situs

32. Which of the following states does not tax trust income?

- A. California
- B. Florida
- C. New Mexico
- D. South Carolina

33. Which statement(s) about changing the situs of a trust is (are) correct?

I. One of the most popular reasons for changing the situs of a trust is to take advantage of a state's more favorable trust laws.

II. As a general rule, advisors recommend against changing the trust situs to a state that has adopted the Uniform Trust Code.

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

34. All of the following statements about modification of a defective irrevocable trust are correct EXCEPT:

- A. In a state that allows for nonjudicial settlement agreements (NJSAs), interested parties can agree to modify certain trust provisions without court involvement or approval.
- B. Among the tools available to settlors to make changes to an irrevocable trust are modification

agreements and decanting.

C. In order for a termination agreement to be implemented outside the court system, the settlor and all beneficiaries must agree and consent to the proposed termination.

D. Use of an NJSA to change the trust situs is not allowed under the Uniform Trust Code.

35. All of the following statements regarding laws governing trusts are correct EXCEPT:

A. The governing law of a trust must always be the state where the grantor or at least one beneficiary resides.

B. Three types of laws governing trusts are validity, construction, and administration.

C. As a general rule, the governing law of a trust will be determined by the language in the trust instrument.

D. The governing law of a trust regarding administration will generally change with a change in the principal place of administration.