

Certified Financial Planner (CFP) Tax Planning Practice Exam (Sample)

Study Guide



Everything you need from our exam experts!

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Introduction

Preparing for a certification exam can feel overwhelming, but with the right tools, it becomes an opportunity to build confidence, sharpen your skills, and move one step closer to your goals. At Examzify, we believe that effective exam preparation isn't just about memorization, it's about understanding the material, identifying knowledge gaps, and building the test-taking strategies that lead to success.

This guide was designed to help you do exactly that.

Whether you're preparing for a licensing exam, professional certification, or entry-level qualification, this book offers structured practice to reinforce key concepts. You'll find a wide range of multiple-choice questions, each followed by clear explanations to help you understand not just the right answer, but why it's correct.

The content in this guide is based on real-world exam objectives and aligned with the types of questions and topics commonly found on official tests. It's ideal for learners who want to:

- Practice answering questions under realistic conditions,
- Improve accuracy and speed,
- Review explanations to strengthen weak areas, and
- Approach the exam with greater confidence.

We recommend using this book not as a stand-alone study tool, but alongside other resources like flashcards, textbooks, or hands-on training. For best results, we recommend working through each question, reflecting on the explanation provided, and revisiting the topics that challenge you most.

Remember: successful test preparation isn't about getting every question right the first time, it's about learning from your mistakes and improving over time. Stay focused, trust the process, and know that every page you turn brings you closer to success.

Let's begin.

How to Use This Guide

This guide is designed to help you study more effectively and approach your exam with confidence. Whether you're reviewing for the first time or doing a final refresh, here's how to get the most out of your Examzify study guide:

1. Start with a Diagnostic Review

Skim through the questions to get a sense of what you know and what you need to focus on. Your goal is to identify knowledge gaps early.

2. Study in Short, Focused Sessions

Break your study time into manageable blocks (e.g. 30 - 45 minutes). Review a handful of questions, reflect on the explanations.

3. Learn from the Explanations

After answering a question, always read the explanation, even if you got it right. It reinforces key points, corrects misunderstandings, and teaches subtle distinctions between similar answers.

4. Track Your Progress

Use bookmarks or notes (if reading digitally) to mark difficult questions. Revisit these regularly and track improvements over time.

5. Simulate the Real Exam

Once you're comfortable, try taking a full set of questions without pausing. Set a timer and simulate test-day conditions to build confidence and time management skills.

6. Repeat and Review

Don't just study once, repetition builds retention. Re-attempt questions after a few days and revisit explanations to reinforce learning. Pair this guide with other Examzify tools like flashcards, and digital practice tests to strengthen your preparation across formats.

There's no single right way to study, but consistent, thoughtful effort always wins. Use this guide flexibly, adapt the tips above to fit your pace and learning style. You've got this!

Questions

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- 1. What defines a "net operating loss" (NOL)?**
 - A. When a company fails to generate revenue**
 - B. When allowable tax deductions exceed taxable income**
 - C. When a company undergoes bankruptcy**
 - D. When operating expenses are higher than revenue**

- 2. The 75% penalty imposed by the IRS for tax underpayment due to fraud is referred to as?**
 - A. Civil fraud.**
 - B. Criminal fraud.**
 - C. Negligence.**
 - D. A frivolous return.**

- 3. What is the primary advantage of having a Flexible Spending Account (FSA)?**
 - A. Unlimited contribution amounts**
 - B. Tax-free withdrawals for qualified expenses**
 - C. Accessibility of funds at any time**
 - D. Ability to carry over funds indefinitely**

- 4. What is the tax implication of passive income when offset by passive losses for Jacinto?**
 - A. The income is entirely offset by the passive loss.**
 - B. The passive losses are fully deductible against any income.**
 - C. Only the income generated from the same partnership can be offset.**
 - D. The passive losses will reduce the taxable income from other sources.**

- 5. In tax terms, which is the benefit of using a child tax credit?**
 - A. 100% exclusion of expenses**
 - B. Reduces tax liability**
 - C. Eligibility for additional deductions**
 - D. None of the above**

6. Why might taxpayers choose to itemize deductions?

- A. To simplify their tax return process**
- B. To maximize their tax refund**
- C. When their total deductions exceed the standard deduction**
- D. To avoid filing electronically**

7. Which of the following is NOT a criterion for a "qualified home"?

- A. The homeowner must reside in the house**
- B. The home must be used primarily for dwelling, not for rental purposes**
- C. The property must be kept in a trust**
- D. The homeowner must have a mortgage on the property**

8. What does the "kiddie tax" apply to?

- A. The earned income of children under 18**
- B. The net investment income of children under 19**
- C. The unearned income of children under 19, taxed at the parent's tax rate**
- D. All income of children under 21**

9. Which of the following correctly describes the filing status for a married couple selling Section 1244 stock?

- A. Married Filing Separate**
- B. Married Filing Jointly**
- C. Single**
- D. Head of Household**

10. What tax treatment applies to the payments Irma will receive from her deferred fixed annuity?

- A. Taxed as ordinary income**
- B. Taxed as capital gains**
- C. Tax free until the investment is recovered**
- D. Taxed only on the interest portion**

Answers

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1. B
2. A
3. B
4. C
5. B
6. C
7. C
8. C
9. B
10. C

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Explanations

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1. What defines a "net operating loss" (NOL)?

- A. When a company fails to generate revenue
- B. When allowable tax deductions exceed taxable income**
- C. When a company undergoes bankruptcy
- D. When operating expenses are higher than revenue

A "net operating loss" (NOL) occurs when a business has allowable tax deductions that exceed its taxable income for a specific tax period. This scenario typically arises when a company incurs significant expenses that surpass the income it generated, leading to a negative taxable income. This negative income can often be carried back to previous tax years or carried forward to offset taxable income in future years, providing potential tax relief. The concept of NOL is critical for businesses as it can strategically affect their tax obligations over time and provide a financial cushion during periods of economic downturn or increased expenses. By utilizing NOLs, companies can improve cash flow and maintain operations despite losses, enhancing their long-term viability and stability. This definition highlights the importance of understanding how tax deductions interact with income levels, which is a fundamental aspect of tax planning for any business.

2. The 75% penalty imposed by the IRS for tax underpayment due to fraud is referred to as?

- A. Civil fraud.**
- B. Criminal fraud.
- C. Negligence.
- D. A frivolous return.

The 75% penalty on tax underpayment due to fraud is regarded as civil fraud. This penalty is applied by the IRS when a taxpayer is found to have intentionally omitted income or claimed improper deductions with the intent to evade taxes. The term "civil fraud" indicates that the matter is handled within civil court proceedings rather than through criminal prosecution. In this context, it's distinct from criminal fraud, which could lead to imprisonment and criminal fines. Civil fraud is focused on the taxpayer's deceitful actions concerning tax obligations and results in significant financial consequences, such as the high penalty rate associated with underpayment. Other options like criminal fraud pertain to illegal actions that can result in jail time and are pursued through the criminal justice system, while negligence involves a failure to take due care in meeting tax obligations, resulting in lower penalties. A frivolous return refers to a tax return that has no basis in law or fact, which also doesn't apply to the context of the significant penalty for fraud.

3. What is the primary advantage of having a Flexible Spending Account (FSA)?

- A. Unlimited contribution amounts
- B. Tax-free withdrawals for qualified expenses**
- C. Accessibility of funds at any time
- D. Ability to carry over funds indefinitely

The primary advantage of having a Flexible Spending Account (FSA) is that it allows for tax-free withdrawals for qualified expenses. This means that contributions to an FSA are made on a pre-tax basis, reducing an individual's taxable income. When money is withdrawn from the FSA to pay for eligible medical expenses, those withdrawals are not subject to federal income tax or Social Security or Medicare taxes. This tax benefit helps individuals save money on healthcare costs, as they can use their pre-tax earnings for qualified expenses such as copayments, deductibles, and certain types of medical care. In contrast, options that suggest unlimited contribution amounts and the ability to carry over funds indefinitely are not accurate regarding FSAs. There are annual limits set by the IRS for contributions, and typically, any unused funds after the plan year ends may be forfeited unless the plan includes a grace period or limited carryover provision.

Furthermore, while FSAs allow easy access to the funds for medical expenses, the claim process must be followed, and funds are not "accessible" in a manner that would let them be used for just any expense without qualifying criteria.

4. What is the tax implication of passive income when offset by passive losses for Jacinto?

- A. The income is entirely offset by the passive loss.
- B. The passive losses are fully deductible against any income.
- C. Only the income generated from the same partnership can be offset.**
- D. The passive losses will reduce the taxable income from other sources.

The correct understanding of tax implications regarding passive income and passive losses lies in the rules governing how these types of income and losses interact under the tax code. Passive income generally comes from rental activities or businesses in which the taxpayer does not materially participate. When it comes to offsetting passive income with passive losses, the primary principle is that passive losses can only offset passive income from the same category, which is precisely what is described in the correct answer. This means that, if Jacinto has passive income from a partnership, the passive losses he may have can only be applied against that specific income from the partnership, not from any other income sources he may have. This aligns with the tax rules that restrict the application of losses, ensuring that one cannot use passive losses to offset non-passive income, thus supporting the position of maintaining a clear delineation between different income types for tax reporting. Therefore, only income generated from the same partnership can be offset by the losses derived from it. Understanding this concept is crucial for effective tax planning, as it helps in strategizing how to manage income streams and potential losses while remaining compliant with tax regulations.

5. In tax terms, which is the benefit of using a child tax credit?

- A. 100% exclusion of expenses**
- B. Reduces tax liability**
- C. Eligibility for additional deductions**
- D. None of the above**

The benefit of using a child tax credit primarily lies in its ability to reduce tax liability. The child tax credit is designed to provide financial relief to families by allowing them to subtract a specific amount per qualifying child from their total tax owed. This effectively lowers the amount of tax that a taxpayer is required to pay, making it a valuable incentive for families with dependent children. This credit is especially important because it can significantly alleviate the financial burden on families, making it easier for them to allocate resources toward essential expenses such as education and healthcare for their children. Additionally, the child tax credit is refundable, meaning that if the credit exceeds the amount of tax owed, the taxpayer may receive a refund for the difference, further enhancing its benefit. Understanding this credit is crucial for effective tax planning, as it can directly influence a family's overall financial strategy and tax payments. The other options presented do not encapsulate the direct impact of the child tax credit on tax liability, making the choice of it being a means to reduce tax liability the clear and correct answer.

6. Why might taxpayers choose to itemize deductions?

- A. To simplify their tax return process**
- B. To maximize their tax refund**
- C. When their total deductions exceed the standard deduction**
- D. To avoid filing electronically**

Taxpayers often choose to itemize deductions when their total deductions surpass the standard deduction available for their filing status. The standard deduction provides a fixed amount that reduces taxable income, but if an individual's allowable deductions—such as mortgage interest, state and local taxes, charitable contributions, and medical expenses—total more than this fixed amount, itemizing those deductions can lead to a lower overall tax liability. By itemizing, taxpayers can take advantage of the specific deductions unique to their financial situation, which could result in significant tax savings. This decision is particularly relevant in scenarios where taxpayers have incurred substantial deductible expenses throughout the year, making itemization more favorable than the standard deduction. The other factors mentioned, such as simplifying the tax return process or aiming to maximize a tax refund, do not directly align with the primary consideration for itemization. Simplicity typically leads many taxpayers to opt for the standard deduction due to its ease. Additionally, while maximizing a tax refund can be a goal, it is ultimately driven by the effective application of deductions, making it secondary to the fundamental choice of itemizing versus taking the standard deduction. Avoiding electronic filing is also unrelated to the decision to itemize.

7. Which of the following is NOT a criterion for a "qualified home"?

- A. The homeowner must reside in the house**
- B. The home must be used primarily for dwelling, not for rental purposes**
- C. The property must be kept in a trust**
- D. The homeowner must have a mortgage on the property**

The correct choice is based on the fact that having a property in a trust is not a criterion that determines whether a home qualifies as a "qualified home" for tax purposes. A "qualified home" typically refers to residences that may qualify for specific tax deductions, such as mortgage interest deductibility under the Internal Revenue Code. For a home to qualify, the resident must live in the property, which ensures it is used as their primary dwelling, thus making option A a necessary criterion. Additionally, the home is intended for personal use rather than for rental, which supports the primary dwelling requirement stated in option B. While many homeowners benefit from having a mortgage, it is not a requirement for defining a "qualified home." Therefore, the ownership structure, such as having the property placed in a trust, does not impact whether the home meets the necessary qualifications for tax benefits. Therefore, option C accurately reflects an aspect that is not necessary for a home to be considered "qualified" in this context.

8. What does the "kiddie tax" apply to?

- A. The earned income of children under 18**
- B. The net investment income of children under 19**
- C. The unearned income of children under 19, taxed at the parent's tax rate**
- D. All income of children under 21**

The "kiddie tax" applies specifically to the unearned income of children under the age of 19, and this income is taxed at the parent's tax rate if it exceeds a certain threshold. This tax is designed to prevent families from shifting large amounts of investment income to their children, who would typically be in a lower tax bracket. Unearned income includes sources such as dividends, interest, and capital gains. The application of the kiddie tax ensures that this type of income is taxed more similarly to how it would be taxed if it were earned by the parents, thereby reducing potential tax avoidance strategies. In terms of age limits, while the general application is for children under 19, there are also specific conditions under which the tax can apply to dependents who are full-time students up to the age of 24. However, the essential core of the kiddie tax principle focuses on unearned income and its taxation in relation to the parent's taxable income, which is precisely why the correct interpretation relates to the unearned income of children under 19.

9. Which of the following correctly describes the filing status for a married couple selling Section 1244 stock?

- A. Married Filing Separate**
- B. Married Filing Jointly**
- C. Single**
- D. Head of Household**

The correct description of the filing status for a married couple selling Section 1244 stock is married filing jointly. Section 1244 stock refers to stock in a small business corporation that allows shareholders to deduct losses on the sale of that stock as ordinary losses rather than capital losses, which can be beneficial in reducing taxable income. When a married couple sells Section 1244 stock, filing jointly typically allows them to combine their incomes and deductions, providing a potentially lower overall tax liability than if they filed separately. Additionally, special tax benefits and standard deductions may apply more favorably to them when they file jointly. This filing status is generally advantageous for married couples to maximize their tax benefits. The other filing statuses listed are not applicable in this situation. For instance, married filing separately does not generally provide the same tax benefits, and the single or head of household statuses are not relevant to a married couple. Thus, the married filing jointly status is the most suitable and beneficial option in this context.

10. What tax treatment applies to the payments Irma will receive from her deferred fixed annuity?

- A. Taxed as ordinary income**
- B. Taxed as capital gains**
- C. Tax free until the investment is recovered**
- D. Taxed only on the interest portion**

The payments Irma will receive from her deferred fixed annuity are generally treated as a return of principal and interest. In the case of annuities, the earnings or interest component is taxed as ordinary income when distributions are taken, while the portion that represents the initial principal is not subject to tax until the investment is fully recovered. When an individual begins to receive payments from a deferred fixed annuity, their contributions (the principal) have already been made with after-tax dollars. Consequently, they do not face taxes on the return of this principal portion. Instead, taxes are only applied to the interest or earnings that have accumulated within the annuity. Understanding this treatment is crucial for planning purposes, as it affects the planning for withdrawals and understanding the tax liabilities associated with annuity payments over time. Therefore, the assertion that payments are tax-free until the investment is recovered appropriately reflects how the tax code handles the return of principal in relation to annuity payments.

Next Steps

Congratulations on reaching the final section of this guide. You've taken a meaningful step toward passing your certification exam and advancing your career.

As you continue preparing, remember that consistent practice, review, and self-reflection are key to success. Make time to revisit difficult topics, simulate exam conditions, and track your progress along the way.

If you need help, have suggestions, or want to share feedback, we'd love to hear from you. Reach out to our team at hello@examzify.com.

Or visit your dedicated course page for more study tools and resources:

<https://cfptaxplanning.examzify.com>

We wish you the very best on your exam journey. You've got this!

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