

Certified Trust and Fiduciary Advisor (CTFA) Practice Exam (Sample)

Study Guide



Everything you need from our exam experts!

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SAMPLE

Questions

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- 1. Which document typically designates how assets will be distributed after death?**
 - A. Living will**
 - B. Power of attorney**
 - C. Last will and testament**
 - D. Trust agreement**
- 2. What is a common characteristic of IRAs and life insurance beneficiary designations?**
 - A. Both must go through probate**
 - B. Both are revocable upon owner's request**
 - C. Both are considered part of the taxable estate**
 - D. Both avoid probate upon the owner's death**
- 3. Which situation would require the filing of an IRS Form 709?**
 - A. A husband gifts \$100,000 of stock to his wife.**
 - B. An individual pays \$23,000 to reimburse her aunt for medical bills.**
 - C. A person gifts \$33,000 to pay a nephew's tuition.**
 - D. A surgeon forfeits his fee for a family member's surgery.**
- 4. Which of the following does NOT constitute a pecuniary bequest?**
 - A. "An amount equal to the applicable exclusion amount"**
 - B. "One hundred dollars"**
 - C. "Two-thirds of my residuary estate"**
 - D. "A sum of money equal to the value of my personal residence"**
- 5. Which of the following statements about AGI and tax deductions is true for Rod?**
 - A. A high AGI results in smaller deductions**
 - B. AGI has no impact on deductions**
 - C. Rod can deduct every expense incurred**
 - D. Rod is limited by the 2% AGI rule for miscellaneous expenses**

- 6. Which medical expense can potentially be deducted on Schedule A?**
- A. Elective LASIK surgery**
 - B. Noncritical facial cosmetic surgery**
 - C. Long-term care insurance premiums**
 - D. Medical expenses for a non-dependent**
- 7. How is the price-to-earnings (P/E) ratio calculated?**
- A. Market value of equity divided by book value of equity**
 - B. Dividend per share divided by earnings per share**
 - C. Stock price per share divided by earnings per share**
 - D. Net income divided by total assets**
- 8. What is a common reason for establishing an irrevocable life insurance trust?**
- A. To maintain control over the policy during the grantor's lifetime**
 - B. To mitigate estate taxes upon the grantor's death**
 - C. To simplify the administration of the grantor's estate**
 - D. To provide immediate access to funds for beneficiaries**
- 9. What is the significance of "fiduciary liability"?**
- A. It represents a trusted position without any legal consequences**
 - B. It means being held accountable for financial advisor opinions**
 - C. It indicates legal responsibility for breaching fiduciary duties**
 - D. It's a situation where the fiduciary can never be sued**
- 10. What is another name for a callable bond investment?**
- A. Convertible bond**
 - B. Refundable bond**
 - C. Redeemable bond**
 - D. Debenture**

Answers

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

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Explanations

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1. Which document typically designates how assets will be distributed after death?

- A. Living will**
- B. Power of attorney**
- C. Last will and testament**
- D. Trust agreement**

The document that typically designates how assets will be distributed after death is the last will and testament. This legal instrument allows an individual, referred to as the testator, to outline their wishes regarding the distribution of their property and other assets upon their death. Through the last will and testament, the testator can name beneficiaries, appoint an executor to manage the estate, and specify any special instructions, such as guardianship for minor children. A living will primarily addresses healthcare decisions and outlines an individual's preferences regarding medical treatment in situations where they are unable to communicate their wishes. Although it is an important document for end-of-life decisions, it does not deal with the distribution of assets. A power of attorney grants authority to another person to manage one's financial or legal affairs during their lifetime, but it does not have any effect after the individual's death. Therefore, it does not provide guidance on asset distribution after death. A trust agreement can also dictate the distribution of assets, but it operates differently from a will. Trusts can manage assets during a person's lifetime and distribute them after death, often allowing for more control and flexibility. However, when directly referring to the act of designating asset distribution specifically upon death, the last will and testament serves as the primary

2. What is a common characteristic of IRAs and life insurance beneficiary designations?

- A. Both must go through probate**
- B. Both are revocable upon owner's request**
- C. Both are considered part of the taxable estate**
- D. Both avoid probate upon the owner's death**

Both IRAs and life insurance beneficiary designations share the characteristic of avoiding probate upon the owner's death. This means that when the owner passes away, the assets held in an IRA or the proceeds from a life insurance policy are transferred directly to the designated beneficiaries without undergoing the often lengthy and public probate process. This direct transfer mechanism is crucial for ensuring that beneficiaries receive their inheritance in a timely manner, as it bypasses potential delays associated with probate court proceedings. For those who have taken the steps to designate beneficiaries on their accounts, it ensures that their financial plans align with their intentions without the complications of the probate process. The other characteristics mentioned in the options, such as going through probate, being revocable upon the owner's request, and being considered part of the taxable estate, do not apply to both IRAs and life insurance beneficiary designations in the same way. For example, while certain aspects of IRAs may impact the taxable estate, the non-probate nature of these assets is a significant factor that enhances their attractiveness for estate planning purposes.

3. Which situation would require the filing of an IRS Form 709?

- A. A husband gifts \$100,000 of stock to his wife.
- B. An individual pays \$23,000 to reimburse her aunt for medical bills.**
- C. A person gifts \$33,000 to pay a nephew's tuition.
- D. A surgeon forfeits his fee for a family member's surgery.

Filing an IRS Form 709, which is the United States Gift (and Generation-Skipping Transfer) Tax Return, is required when an individual makes a gift that exceeds the annual exclusion limit. For the year in question, the annual exclusion is pertinent for gifts made to an individual that exceed this threshold. When analyzing the scenarios, the situation that necessitates the filing of Form 709 is the one where someone gifts more than the annual exclusion limit. In the case described where a person gifts \$33,000 to pay a nephew's tuition, this exceeds the annual exclusion limit and thus would require reporting on Form 709, since the amount exceeds the limit that can be gifted without implications for gift tax. On the other hand, the husband gifting \$100,000 of stock to his wife does not require Form 709 because gifts between spouses are generally exempt from gift taxes. Reimbursing an aunt for medical bills also falls outside the scope because direct payments for medical expenses made on behalf of another, if made directly to the provider, are excluded from gift tax calculations. Lastly, a surgeon forfeiting his fee for a family member's surgery does not constitute a gift as it is not a transfer of assets or ownership, thus it doesn't meet

4. Which of the following does NOT constitute a pecuniary bequest?

- A. "An amount equal to the applicable exclusion amount"
- B. "One hundred dollars"
- C. "Two-thirds of my residuary estate"**
- D. "A sum of money equal to the value of my personal residence"

A pecuniary bequest is defined as a specific amount of money given to a beneficiary from an estate. In this context, the correct answer indicates what does not fit this definition. The phrase "two-thirds of my residuary estate" does not constitute a pecuniary bequest because it refers to a portion of the remaining assets in the estate after debts, taxes, and specific bequests have been paid. Residuary bequests are typically expressed as a percentage of what is left over, rather than a fixed sum of money. In contrast, the other options provide explicit amounts or a valuation that's monetary in nature. For example, an "amount equal to the applicable exclusion amount," "one hundred dollars," and "a sum of money equal to the value of my personal residence" all clearly define fixed or calculable monetary values, qualifying them as pecuniary bequests.

5. Which of the following statements about AGI and tax deductions is true for Rod?

- A. A high AGI results in smaller deductions**
- B. AGI has no impact on deductions**
- C. Rod can deduct every expense incurred**
- D. Rod is limited by the 2% AGI rule for miscellaneous expenses**

The statement that Rod is limited by the 2% AGI rule for miscellaneous expenses is accurate. The 2% AGI rule specifies that only the portion of a taxpayer's miscellaneous itemized deductions that exceed 2% of their Adjusted Gross Income (AGI) is deductible. This means that if Rod's AGI is high, more of his miscellaneous expenses may not be deductible, as only the amount above this threshold would qualify. This rule is vital for understanding how AGI affects the actual deduction amount a taxpayer can claim. The other statements do not accurately reflect the nuances of how AGI interacts with deductions. For instance, while a high AGI may influence the percentage of deductions available, it doesn't directly correlate to "smaller deductions" across the board without considering specific categories of deductions. Furthermore, AGI does have implications for certain deductions, so it cannot be stated that it has no impact at all. Finally, the notion that Rod can deduct every expense incurred is overly broad; not all expenses qualify for deductions, particularly if they do not meet specific criteria established by the tax code.

6. Which medical expense can potentially be deducted on Schedule A?

- A. Elective LASIK surgery**
- B. Noncritical facial cosmetic surgery**
- C. Long-term care insurance premiums**
- D. Medical expenses for a non-dependent**

Long-term care insurance premiums can be potentially deducted on Schedule A if certain criteria are met. The IRS allows taxpayers to deduct qualified long-term care insurance premiums as part of their medical expense deduction, which is available to itemizers. The deduction amounts are subject to limitations based on the age of the taxpayer, and they must be within the overall threshold for unreimbursed medical expenses, which is typically set at 7.5% of adjusted gross income. On the other hand, elective LASIK surgery, while it may be considered a medically necessary procedure for some, is generally not deductible unless prescribed specifically for medical reasons. Noncritical facial cosmetic surgery is usually not deductible unless it is performed to improve a deformity related to a congenital abnormality, an accident, or a disfiguring disease. Medical expenses for a non-dependent do not qualify for a deduction since only expenses related to dependents and the taxpayer themselves can be considered for medical expense deductions. Thus, long-term care insurance premiums stand out as a deductible medical expense on Schedule A, reinforcing the importance of understanding the specific eligibility criteria surrounding medical deductions.

7. How is the price-to-earnings (P/E) ratio calculated?

- A. Market value of equity divided by book value of equity
- B. Dividend per share divided by earnings per share
- C. Stock price per share divided by earnings per share**
- D. Net income divided by total assets

The price-to-earnings (P/E) ratio is a significant financial metric used to assess a company's valuation relative to its earnings. It is calculated by taking the stock price per share and dividing it by the earnings per share (EPS). This ratio provides insight into how much investors are willing to pay for a dollar of the company's earnings, making it a valuable tool for comparing the valuation of different companies or assessing the growth potential of a single firm. When the stock price is high in relation to earnings, it may suggest that investors are expecting higher growth rates in the future. Conversely, a low P/E ratio might indicate that the stock is undervalued or that the company is experiencing difficulties. Understanding the correct formula is key for those preparing for the CTFA exam, as the P/E ratio has implications for investment decisions and portfolio management. Other calculations, such as market value versus book value or dividend payouts, fulfill different financial analysis purposes and do not represent the P/E ratio.

8. What is a common reason for establishing an irrevocable life insurance trust?

- A. To maintain control over the policy during the grantor's lifetime
- B. To mitigate estate taxes upon the grantor's death**
- C. To simplify the administration of the grantor's estate
- D. To provide immediate access to funds for beneficiaries

The establishment of an irrevocable life insurance trust (ILIT) is commonly pursued to mitigate estate taxes upon the grantor's death. When an individual creates an ILIT, the life insurance policy is transferred to the trust, removing it from the grantor's taxable estate. This means that the death benefit from the policy will not be included in the grantor's estate value, thus potentially reducing estate taxes owed. By using an ILIT, it allows the policy proceeds to pass to the beneficiaries without being subject to the estate tax burden, ensuring that they receive the full intended value of the insurance without the erosive impact of taxation. While other options might suggest reasons for creating a trust, they do not align with the primary purpose of establishing an ILIT. For instance, maintaining control over the policy during the grantor's lifetime contradicts the irrevocable nature of the trust, which removes that control. Additionally, while simplifying estate administration and providing immediate access to funds could be goals associated with various trusts, they are less specific to the unique benefits of an ILIT, which primarily focuses on tax mitigation.

9. What is the significance of "fiduciary liability"?

- A. It represents a trusted position without any legal consequences
- B. It means being held accountable for financial advisor opinions
- C. It indicates legal responsibility for breaching fiduciary duties**
- D. It's a situation where the fiduciary can never be sued

The significance of "fiduciary liability" lies in the legal responsibility it denotes for individuals in a fiduciary role when they breach their fiduciary duties. Fiduciaries are entrusted with the responsibility to act in the best interest of another party, typically in financial matters. This includes duties such as loyalty, care, and full disclosure. Should a fiduciary fail to uphold these duties—whether through negligence, conflicts of interest, or any actions that do not align with the best interests of the beneficiary—they can be held legally liable. This liability serves as an essential safeguard for beneficiaries, ensuring that those in fiduciary positions are accountable for their actions and must adhere to high ethical and professional standards. It also functions as a form of legal recourse for beneficiaries who may suffer damages due to a fiduciary's misconduct. In contrast, the other options provide descriptions that do not accurately convey the implications of fiduciary liability. A suggests a trusted position without legal consequences, which misrepresents the nature of fiduciary responsibility. B conflates fiduciary liability with general accountability for opinions rather than focusing on the fiduciary's obligation to avoid breaches of duty. D incorrectly states that fiduciaries can never be sued, while in reality, fiduciaries can indeed face legal action.

10. What is another name for a callable bond investment?

- A. Convertible bond
- B. Refundable bond
- C. Redeemable bond**
- D. Debenture

A callable bond is a type of bond that allows the issuer to redeem the bond before its maturity date, usually at a specified call price. This feature gives issuers flexibility, especially if interest rates decline, allowing them to refinance their debts at lower rates. The term "redeemable bond" effectively refers to this same characteristic, as it indicates that the bond can be redeemed or bought back by the issuer prior to its maturity. This aligns with the nature of callable bonds, which can be redeemed by the issuer according to the terms set forth at the issuance. In contrast, a convertible bond refers to bonds that can be converted into a predetermined number of the issuer's equity shares, which does not pertain to the callable feature. A refundable bond is not a standard term used in bond markets, and while it might imply a similar concept, it is not widely recognized or used. Lastly, a debenture typically refers to a type of unsecured bond based on the creditworthiness and reputation of the issuer, rather than its callability. Thus, among the provided options, "redeemable bond" is the most accurate alternative name for a callable bond investment.