QBank Quiz December 1, 2017

Test ID: 59460372

Question #1 of 214

Question ID: 607231

A security you purchased several years ago has appreciated substantially in value. You have decided to donate the investment to your favorite charity. What will the cost basis be to the charity that receives your gift?

- ✓ **A)** The value of the securities at the time the charitable donation is made.
- ✗ **B)** Your cost basis plus any capital gains taxes that you have paid on the security.
- ✗ **C)** Zero since you gave the position to the charity as a contribution, having paid taxes on the gain while you held it.
- ✗ **D)** Your cost basis, created at the initial purchase of the security.

Explanation

If a donation is made to a registered charity, the charity's cost basis is fair market value as of the date of the contribution.

Reference: 15.5.9.1.1 in the License Exam Manual

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Question ID: 607232

ABC Corporation owns stock in XYZ Corporation. What percentage of dividends paid by XYZ to ABC is taxable to ABC?

- ✗ **A)** 70%.
- ✗ **B)** 100%.
- ✓ **C)** 30%.
- ✗ **D)** 50%.

Explanation

The corporate dividend exclusion permits a corporation receiving dividends from another corporation to exclude 70% of those payments. Therefore, the corporation will pay tax only on the remaining 30%. This exclusion applies only to dividends, not interest.

Reference: 15.5.11.1 in the License Exam Manual

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Question ID: 607199

Which combination of the following statements is TRUE regarding the investment strategy known as "dollar-cost averaging"?

I. Invests the same dollar amount each period over a length of time.
II. Purchases the same number of shares each period over a length of time.
III. Lowers average cost per share over a length of time (assuming share price fluctuations).
IV. Invests the same dollar amount each period to protect the investment from loss of capital.

- ✗ **A)** II and IV.
- ✓ **B)** I and III.
- ✗ **C)** II and III.
- ✗ **D)** I and II.

Explanation

Dollar cost averaging is when an equal dollar amount is invested periodically. This does not prevent capital losses but can lower the average cost per share because of periods of decline in the stock price. During those times, the fixed dollar amount will allow for the purchase of more shares at the lower price.

Reference: 15.4.1.2 in the License Exam Manual

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Question ID: 607254

A 3% bond with 20 years to maturity is being issued by a syndicate with a reoffering yield of 4%. What is the term used to describe this bond?

✗ **A)** High-yield bond.
✗ **B)** Secondary market discount.
✓ **C)** Original issue discount.
✗ **D)** Original issue premium.

Explanation

Because the bond is being issued by a syndicate, it is a new issue (i.e., an original issue). Because the yield (4%) is higher than the coupon (3%), it is an original issue discount.

Reference: 15.5.7.2 in the License Exam Manual

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Question ID: 607203

Which of the following statements regarding stock dividends are TRUE?

I. They are taxable as ordinary income on receipt.
II. They are not taxable on receipt.
III. Cost basis per share is reduced.
IV. Cost basis per share remains the same.

✗ **A)** I and IV.
✓ **B)** II and III.
✗ **C)** I and III.
✗ **D)** II and IV.

Explanation

Stock dividends are not taxed; rather, the basis in each share of stock owned is adjusted downward proportionately.

Reference: 15.5.6.1 in the License Exam Manual

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Question ID: 607259

A married couple who files jointly has a $5,000 long-term capital loss with no offsetting capital gains. Regarding the tax treatment of this loss, all of the following statements are true EXCEPT:

✓ **A)** capital losses can be used to offset capital gains only.
✗ **B)** they can carry forward $2,000 to future years.
✗ **C)** the maximum they can deduct this year is $3,000.
✗ **D)** capital losses can be deducted dollar for dollar against capital gains.

Explanation

Capital losses are deducted from ordinary income and, therefore, reduce tax liability. The maximum that individuals or married couples can deduct is $3,000 annually. If the long-term capital loss exceeds the maximum, the excess is carried forward to future years until the loss is exhausted. Under current IRS regulations, $1 in losses results in $1 in deductions.

Reference: 15.5.6.1.3 in the License Exam Manual

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Question ID: 607307

Broker/dealers must report cost basis and sales proceeds

✗ **A)** to customers and the IRS each time a transaction occurs separately
✗ **B)** never
✗ **C)** to the IRS only, on a monthly basis
✓ **D)** to customers and the IRS annually

Explanation

Broker/dealers (BDs) are required to report both cost basis and sales proceeds to both their customers and the IRS annually.

Reference: 15.5.6.2 in the License Exam Manual

Question #8 of 214

Question ID: 607144

Changing any of the following characteristics of the stocks and bonds in an investor's portfolio would likely add diversification EXCEPT the:

- ✗ **A)** issuer's geographic location.
- ✗ **B)** industries in which she is investing.
- ✗ **C)** types of securities.
- ✓ **D)** securities' relative prices.

Explanation

Portfolio diversification is rarely achieved by price alone. Geographic diversification disburses risk if growth rates vary in separate parts of the country. Diversifying holdings among industries helps as different economic situations affect some industries more than others. Diversifying types of securities helps as bonds react differently from stocks and real estate to changing economic situations.

Reference: 15.2.2.5 in the License Exam Manual

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Question ID: 607251

On September 1, an investor sold 100 shares of KLP Corporation common stock for a loss of $1 per share. On September 15, he purchased a KLP convertible bond with a conversion price of $40. How much of the original loss may he now declare for tax purposes?

- ✗ **A)** $40.
- ✗ **B)** $100.
- ✗ **C)** He may not declare any loss.
- ✓ **D)** $75.

Explanation

Since he purchased the convertible bond less than 30 days after realizing the loss, the sale of the stock falls under the wash sale rule; Investors who sell securities at a loss, and repurchase them, including their equivalents, 30 days before or after the sale will have the loss disallowed by the IRS. With a conversion price of $40, the bond could be converted into 25 shares (1,000 / 40) of KLP common stock. Hence, the investor has "bought back" the equivalent of 25 shares, and may only declare a $75 loss as the remaining $25 loss will be disallowed.

Reference: 15.5.6.3 in the License Exam Manual

Question #10 of 214

Question ID: 607250

If a customer has sold 1,000 shares of XYZ at a loss, a wash sale will result within 30 days of the date of sale if your customer:

- ✓ **A)** buys 10 XYZ at the money calls.
- ✗ **B)** buys 10 XYZ at the money puts.
- ✗ **C)** writes 10 XYZ at the money puts.
- ✗ **D)** writes 10 XYZ at the money calls.

Explanation

If, within 30 days of the date of sale, the customer buys back the security or the right to buy it back (a call option), the loss is disallowed. It will also be disallowed if the customer writes deep in-the-money puts on the security sold within 30 days. A deep in-the-money put will likely be exercised, forcing the customer to buy stock.

Reference: 15.5.6.3 in the License Exam Manual

Question #11 of 214

Question ID: 607314

A strategy designed to lock in a capital gain, not realize it currently for tax purposes but instead defer it to a later tax period, is known as

✗ **A)** arbitrage

✗ **B)** hedging

✓ **C)** short against the box

✗ **D)** share identification when closing a position

Explanation

Shorting against the box is a tax strategy used to lock in capital gains in a long position and defer them to a later period. The strategy involves selling short shares that are currently owned in the long position when a profit already exists in the long position. From that point forward, each dollar lost in the long position, if the stock should fall, is offset by a gain in the short position and vice versa. There are a number of criteria that must be met for the IRS to allow this strategy.

Reference: 15.5.9.4 in the License Exam Manual

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Question ID: 607209

Income from which of the following investments is passive income?

I. Real estate DPP.
II. Vacation cottage rentals.
III. REITs.
IV. CMOs.

✗ **A)** II and IV.

✗ **B)** I and III.

✓ **C)** I and II.

✗ **D)** II and III.

Explanation

Passive income results from DPPs and personal real estate rentals. REITs and CMOs are securities; income from securities is considered portfolio income.

Reference: 15.5.3.2 in the License Exam Manual

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Question ID: 607224

A municipal bond is purchased at a discount in the secondary market at 90. The face amount is $10,000 and the bond has 10 years to maturity. If the bond is sold for 97 after 5 years, what is the taxable gain?

✗ **A)** $700.

✗ **B)** $300.

✓ **C)** $200.

✗ **D)** Capital gains are not taxable on municipal issues.

Explanation

When a municipal bond is bought at a discount in the secondary market, the discount is accreted and taxable as ordinary income. Accretion increases cost basis. Therefore, 5 years later, the bond's cost basis is 95. At that point, the customer has a 2-point capital gain. Had the bond been bought as an OID, the annual accretion is considered interest income and is not taxable.

Reference: 15.5.7.2 in the License Exam Manual

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Question ID: 607122

If a new customer is preparing to buy his first home within the next year, and his investment objective is aggressive growth, which of the following investments would be *most* suitable for your customer's portfolio?

✓ **A)** T-bills.

✗ **B)** Growth stocks.

✗ **C)** High-yield bond fund.

✗ **D)** Blue-chip equity fund.

Explanation

While his profile indicates aggressive growth, the fact that he will need his funds in a year or less to purchase a home is the major consideration. With such a short time horizon, any equity investment involves too much risk, as does an investment in a high-yield bond fund. Of the choices, T-bills make the most sense.

Reference: 15.1.2 in the License Exam Manual

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Question ID: 607243

A New Jersey client in the highest tax bracket wants to minimize his tax burden. The interest on which of the following securities is exempt from federal, state, and local taxes?

✗ **A)** City of New York general obligation bonds.
✗ **B)** GNMA pass-through certificates.
✓ **C)** Bonds issued by the Commonwealth of Puerto Rico.
✗ **D)** Treasury bills.

Explanation

Bond issues by protectorates of the United States (Guam, Puerto Rico, and the U.S. Virgin Islands) are triple tax exempt: federal, state, and local. Interest income from municipal bonds is federal tax exempt, but is not state tax exempt unless the bondholder is a resident of the state where the bonds are issued. Interest from Treasury bills and most other government and agency securities is state tax exempt, but is subject to federal taxes. Exceptions are GNMA and FNMA securities, which are taxed on all levels.

Reference: 15.5.4.1.2 in the License Exam Manual

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Question ID: 607303

An investor purchases a corporate bond at 105 with a 10-year stated maturity and pays $30 of accrued interest. If he elects not to amortize the premium and holds the bond to maturity, what is his cost basis for tax purposes?

✗ **A)** 1000.
✗ **B)** 1020.
✓ **C)** 1050.
✗ **D)** 1080.

Explanation

While most taxpayers do elect to amortize the premium paid for a corporate bond, it is not mandatory. The investor chooses not to amortize, thus his cost basis at maturity is simply what he originally paid for the bond. Accrued interest paid does not affect cost basis.

Reference: 15.5.7.1 in the License Exam Manual

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Question ID: 607131

A registered representative with ABC Securities has recently become aware of a new variable annuity. As tax time is approaching, the representative decides to recommend the variable annuity to all of his customers as an attractive addition to their portfolios. The representative should:

I. recommend the variable annuity to all of his clients because the tax advantage almost always results in a greater return.
II. recommend the variable annuity to those clients whose needs and objectives match the investment.
III. recommend the variable annuity to all of his clients because of the performance potential of the subaccounts.
IV. not recommend the investment to all of his clients in spite of the tax advantages and additional features.

✓ **A)** II and IV.
✗ **B)** II and III.
✗ **C)** I and IV.
✗ **D)** I and III.

Explanation

Recommendations may be made only when it is suitable for the customer's needs. Therefore, he would not recommend the variable annuity to all of his clients despite the tax advantages.

Reference: 15.2.1 in the License Exam Manual

Question #18 of 214

Question ID: 607208

If a customer has $9,000 of capital losses and $2,000 of capital gains in a tax year, that year's consequences are a:

- ✗ **A)** $3,000 loss deduction with no carry forward.
- ✗ **B)** $9,000 loss deduction.
- ✓ **C)** $3,000 loss deduction with $4,000 carry forward.
- ✗ **D)** $7,000 loss deduction with no carry forward.

Explanation

For tax purposes, the customer can net gains with losses. In this case, the customer's net losses are $7,000. However, there is an annual capital loss deduction limit of $3,000. Therefore, the investor can deduct $3,000 this year and carry forward $4,000 to the following tax year.

Reference: 15.5.6.1.3 in the License Exam Manual

Question #19 of 214

Question ID: 607116

A registered representative's recommendations to a customer:

- ✓ **A)** must match the customer's risk tolerance and investment objectives.
- ✗ **B)** must be approved in advance by a principal.
- ✗ **C)** must be reviewed by a principal whether or not they result in a trade.
- ✗ **D)** are not covered by FINRA rules.

Explanation

Recommendations made to a customer must be suitable for that customer. Individual recommendations do not require advance approval or review by a principal, though the resulting trade, if one occurs, must be reviewed by a principal.

Reference: 15.1.2.4 in the License Exam Manual

Question #20 of 214

Question ID: 607119

Which of the following statements *best* describes the term "churning"?

- ✗ **A)** Making false or misleading statements to a customer for the purpose of inducing the customer to purchase or sell a security.
- ✓ **B)** Trading in a customer's account considered excessive, and for which no discernible investment purpose is detected.
- ✗ **C)** Purchasing the same security in more than one customer account at a time.
- ✗ **D)** Manipulation of market prices by a firm.

Explanation

Churning is excessive trading for a particular customer's circumstances or exceeding what would normally be considered suitable. This is equally true for both discretionary and nondiscretionary accounts.

Reference: 15.1.3.1 in the License Exam Manual

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Question ID: 607277

Most taxes in the U.S. fit into one of two categories. They are either progressive or regressive. Which of the following taxes are known as progressive taxes?

I. Sales.
II. Cigarette.

III. Income.
IV. Estate.

- ✓ **A)** III and IV.
- ✗ **B)** II and IV.
- ✗ **C)** I and II.
- ✗ **D)** I and III.

Explanation

With a progressive tax, the percentage amount increases as the taxable amount increases such as income and estate taxes. Sales and cigarette taxes are regressive because all persons pay the same percentage tax regardless of their income.

Reference: 15.5.2 in the License Exam Manual

Question #22 of 214

Question ID: 607266

By which government is the income from eurodollar bonds always taxed?

- ✗ **A)** Government of the country in whose currency the bonds are denominated.
- ✓ **B)** Government of the country in which the investor pays taxes.
- ✗ **C)** No tax is levied.
- ✗ **D)** Government of the country that issued the bonds.

Explanation

The income from a foreign investment is taxable to the investor under the rules of the country in which he pays taxes. The income may also be taxable in the country of issuance. In this case, the investor would receive a tax credit in order to avoid dual liability.

Reference: 15.5.4.3 in the License Exam Manual

Question #23 of 214

Question ID: 607225

If a customer buys $28,000 of ABC stock in April of 1999 and at year end, the stock is worth $23,000, how much may the customer deduct on his 1999 tax return?

- ✗ **A)** $2,000.
- ✓ **B)** $0.
- ✗ **C)** $3,000.
- ✗ **D)** $5,000.

Explanation

Until the customer realizes the loss by selling, there is no tax deduction.

Reference: 15.5.6 in the License Exam Manual

Question #24 of 214

Question ID: 607183

Your customer's portfolio consists of 40% long-term government bonds, 20% preferred stock, and 40% common shares of utility companies. Which of the following may have the single largest impact on the entire portfolio?

- ✗ **A)** Corporate earnings
- ✗ **B)** Oil and gas price movements
- ✗ **C)** Foreign currency fluctuations
- ✓ **D)** Interest rate movements

Explanation

Of the four answer choices, interest rate movement is the most likely to impact each of the portfolio components. Interest rates and bond prices have an inverse relationship, and their movement often determines whether investors might seek out investment alternatives with higher returns, such as dividend paying utilities and fixed dividend preferred shares.

Reference: 15.3.2.4 in the License Exam Manual

Question #25 of 214

Question ID: 607270

Amortization of a municipal bond premium does which of the following?

I. Increases cost basis.
II. Decreases cost basis.
III. Increases reported interest income.
IV. Decreases reported interest income.

- ✗ **A)** II and III.
- ✓ **B)** II and IV.
- ✗ **C)** I and IV.
- ✗ **D)** I and III.

Explanation

Tax law requires municipal bond premiums to be amortized. The effect of amortization is to decrease reported interest income and cost basis. If held to maturity, the cost basis will have been amortized down to par. Therefore, at maturity, there is no reported capital loss.

Reference: 15.5.7.1 in the License Exam Manual

Question #26 of 214

Question ID: 607284

An investor purchases 100 shares of XYZ common stock for $70 and sells it one year later for $50. Which of the following activities would violate the wash sale rule?

I. Purchasing an XYZ call option 20 days after the sale.
II. Purchasing an XYZ put option 20 days after the sale.
III. Purchasing 100 shares of XYZ common stock 20 days after the sale.
IV. Selling short 100 shares of XYZ common stock 20 days after the sale.

- ✗ **A)** II and IV.
- ✓ **B)** I and III.
- ✗ **C)** III and IV.
- ✗ **D)** I and II.

Explanation

The wash sale rule is violated when an investor sells a security at a loss and purchases the same or a substantially identical security within 30 days of the sale date. The IRS considers a call option substantially identical to the underlying stock because it represents the right to buy the shares.

Reference: 15.5.6.3 in the License Exam Manual

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Question ID: 607170

The ABCD Corporation has a beta coefficient of 1.25. Your client's portfolio contains $20,000 of ABCD. After a rise in the overall market of 10%, we would expect the value of this client's ABCD to:

- ✗ **A)** decrease by 25%.
- ✗ **B)** increase by $5,000.
- ✓ **C)** increase by $2,500.
- ✗ **D)** increase by $2,000.

Explanation

A stock with a beta coefficient of 1.25 could be expected to rise in value at a rate 25% greater than the overall market. Since the market has increased by 10%, this stock should increase by 12.5% or $2,500 (10% × 1.25 × $20,000 = $2,500).

Reference: 15.3.3.1 in the License Exam Manual

Question #28 of 214

Question ID: 607171

Which of the following bonds is *most* affected by interest rate risk?

- ✓ **A)** 7.6s of '31 yielding 7.2%.
- ✗ **B)** 7.8s of '27 yielding 7.3%.
- ✗ **C)** 7s of '22 yielding 7%.
- ✗ **D)** 7.5s of '24 yielding 7.2%.

Explanation

Interest rate risk is the loss in value due to a rise in interest rates. Since there is little difference in coupon rates, the bond with the longest maturity (highest duration) will experience the greatest fall in a rising interest rate market.

Reference: 15.3.2.4 in the License Exam Manual

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Question ID: 607244

An investor purchases a municipal bond at par to yield 5.5% to maturity. Two years later, if he sells the bonds at a price equivalent to a 5% yield to maturity, the investor incurs:

- ✗ **A)** a capital loss.
- ✓ **B)** a capital gain.
- ✗ **C)** no taxable result at this time.
- ✗ **D)** tax-free income.

Explanation

Yields fall as bond prices rise. Because the yield to maturity has dropped, the bond is trading at a higher price than when it was purchased. The consequence of the sale is a capital gain, because the investor sold at a premium the bond that was purchased for par.

Reference: 15.5.6 in the License Exam Manual

Question #30 of 214

Question ID: 607162

If your customer is pursuing an aggressive stock buying strategy, which of the following is *most* suitable for him?

- ✗ **A)** Convertible bonds of a mid-cap company.
- ✗ **B)** DEF stock with a beta coefficient of .93.
- ✗ **C)** ABC stock with a beta coefficient of 1.0.
- ✓ **D)** GHI stock with a beta coefficient of 1.20.

Explanation

Beta coefficients greater than 1.0 signify that the stock will fluctuate more than the market as a whole. In general, the higher the beta is, the greater the risk. Such risk-taking is appropriate for investors who seek aggressive stock-buying strategies and have both the financial ability and the temperament to withstand downturns in the market.

Reference: 15.3.3.1 in the License Exam Manual

Question #31 of 214

Question ID: 607135

Which of the following investments is *most* suitable for an investor seeking monthly income?

- ✗ **A)** Zero-coupon bond.
- ✗ **B)** Mutual fund investing in small-cap issues.
- ✓ **C)** Money-market mutual fund.
- ✗ **D)** Growth stock.

Explanation

The money-market mutual fund is the most suitable investment for an investor seeking monthly income. The other securities offer higher long-term growth potential, but they are not designed to provide monthly income.

Reference: 15.2.2.2 in the License Exam Manual

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Question ID: 607113

All of the following require prior notification by a registered representative to his broker/dealer EXCEPT

- ✗ **A)** when he takes a part-time job during the holiday season to earn extra money
- ✗ **B)** when he is invited to sit on the board of directors of a local business
- ✗ **C)** when he assists in the private distribution of securities for a non-profit organization
- ✓ **D)** when he volunteers on the telephones for a fund-raising campaign for the local college

Explanation

Volunteer fund raising for the local college, since it is not a business or securities activity, would not require prior notification of his broker/dealer.

Reference: 15.1.2.2 in the License Exam Manual

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Question ID: 607191

A portfolio that invests in blue-chip stocks and growth stocks can *best* be described as:

- ✗ **A)** an aggressive portfolio.
- ✓ **B)** a growth and income portfolio.
- ✗ **C)** a balanced portfolio.
- ✗ **D)** a high-yield portfolio.

Explanation

A growth and income portfolio typically combines conservative blue-chip securities for their stability and capital preservation with growth stocks for their appreciation potential. An aggressive portfolio contains securities of smaller companies that have the potential for significant capital appreciation. A balanced portfolio invests in both stocks and bonds.

Reference: 15.4.3.1 in the License Exam Manual

Question #34 of 214

Question ID: 607134

A change in which of the following should be indicated in a customer's file?

I. Name.
II. Educational degrees held.
III. Investment objectives.
IV. Professional society memberships.

- ✗ **A)** III and IV.
- ✓ **B)** I and III.
- ✗ **C)** II and IV.
- ✗ **D)** I and II.

Explanation

All primary information, such as name, address, and Social Security number, and all information that could affect recommendations or a customer's financial situation must be noted immediately in the file. Educational degrees and society memberships do not affect investment recommendations.

Reference: 15.2.1 in the License Exam Manual

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Question ID: 607181

A customer, age 72, retired and on a fixed income wants to invest $50,000 in small-cap stocks in an account set up as JTWROS with a spouse. As a registered representative you feel the transactions to be unsuitable for the customer. Therefore you should:

- ✓ **A)** discuss with the customer why small-cap stocks might not be appropriate given the circumstances as you know them before entering any orders.
- ✗ **B)** refuse the trade as unsuitable.
- ✗ **C)** require documentation from the other party to the JTWROS account showing they agree with the proposed transactions.
- ✗ **D)** enter the trade without question or discussion.

Explanation

If a registered representative (RR) feels the proposed transactions might not be suitable for the customer there is no obligation by industry rule to refuse the trade but there is however a responsibility to explain so to them before entering any orders. In a JTWROS account either party may enter trades without the prior consent of the other party.

Reference: 15.3.1 in the License Exam Manual

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Question ID: 607274

A customer purchased 10 municipal OID bonds at 92. If he holds them to maturity, he will be federally taxed on which of the following?

- ✓ **A)** $0.
- ✗ **B)** $800.
- ✗ **C)** $8,000.
- ✗ **D)** $80.

Explanation

The key here is OID, which stands for original issue discount. The discount on OID bonds is considered interest. A municipal bond interest is tax free. Therefore the profit realized from the difference between the discounted purchase price and the redemption price at maturity is also considered federally tax free. If the owner lives in the state within which the bonds are issued, they will be state and local tax free as well.

Reference: 15.5.7.2 in the License Exam Manual

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Question ID: 607137

A couple in their early 30s has been married for 4 years, their disposable income is relatively high, and they are planning to buy a condominium. If they need a safe place to invest their down payment for about 6 months, which of the following mutual funds is the *most* suitable for these customers?

- ✗ **A)** ATF Capital Appreciation Fund.
- ✗ **B)** XYZ Investment-Grade Bond Fund.
- ✓ **C)** LMN Cash Reserves Money Market Fund.
- ✗ **D)** ABC Growth & Income Fund.

Explanation

These customers are preparing to make a major purchase within the next few months, so they require a highly liquid investment to keep their money safe for a short amount of time. The money market fund best matches this objective.

Reference: 15.2.1.2 in the License Exam Manual

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Question ID: 607146

A registered representative is interviewing a new customer, age 27. The customer wants to list capital appreciation as the primary investment objective for the account and is willing to take a moderate degree of risk at this time in his life. The customer also notes concern about inflation and how it will impact his portfolio over time. Which of the following investments is the most suitable recommendation?

- ✗ **A)** Corporate debt securities
- ✓ **B)** Equities such as common and preferred stock

- ✗ **C)** Long-term government bonds
- ✗ **D)** Municipal debt securities

Explanation

Equities would be the most appropriate investment given the customer's age, capital appreciation investment objective and willingness to accept moderate risk. The remaining answer choices, while each has varying risk characteristics, are not likely to meet the capital appreciation objective.

Reference: 15.2.2.7 in the License Exam Manual

Question #39 of 214

Question ID: 607114

Your next-door neighbor approaches you with a proposed security offering, knowing that you are a registered representative with a large, affluent client base. If he asks you to present this investment opportunity to your clients, you must tell him that:

- ✗ **A)** you will present the offering to your clients only after you have established that it is either registered or exempt from registration requirements.
- ✗ **B)** you may make recommendations on the offering only after you have done a due diligence determination.
- ✓ **C)** you must first show the offering to your broker/dealer and receive permission to proceed with it.
- ✗ **D)** you will present the offering only to those clients whose investment objectives make it a suitable purchase for them.

Explanation

You must receive permission from your broker/dealer before you sell or offer for sale any security to your clients. To avoid a charge of selling away, you must also see to it that any sales that result are carried on your broker/dealer's books.

Reference: 15.1.2.3 in the License Exam Manual

Question #40 of 214

Question ID: 607227

A municipal bond is purchased in the secondary market at 102½. The bond has 5 years to maturity. Two years later, the bond is sold for 102. The tax consequence to the investor is:

- ✓ **A)** a capital gain of $5 per bond.
- ✗ **B)** a capital loss of $5 per bond.
- ✗ **C)** no capital gain or loss.
- ✗ **D)** a capital loss of $20 per bond.

Explanation

Municipal bonds bought at a premium, either in the new issue or secondary market, must be amortized. The amount of the premium is 2½ points or $25. As the bond has 5 years to maturity, the annual amortization amount is $5 per bond. After 2 years, the bond's basis has been amortized down to 101½. At that point, a sale at 102 generates a capital gain of $5 per bond.

Reference: 15.5.7.1 in the License Exam Manual

Question #41 of 214

Question ID: 607293

An investor purchases 100 shares of CDE on December 20, 2000, for $2,000. On the same day, he purchases 100 shares of QRS for $2,000. On January 3, 2001, he sells the CDE stock for $1,700 and the QRS stock for $2,200. On January 24, 2001, he purchases 200 shares of CDE for $3,000. What capital gains or losses did he realize from these transactions?

- ✗ **A)** $300 loss in CDE.
- ✓ **B)** $200 gain in QRS.
- ✗ **C)** $300 loss in QRS and $200 gain in CDE.
- ✗ **D)** $300 loss in CDE and $200 gain in QRS.

Explanation

The investor in this question has a $200 capital gain to report on the purchase of QRS stock for $2,000 and its subsequent sale for $2,200. Because the investor repurchased the CDE stock (January 24) within 30 days of selling it (January 3), the $300 loss incurred ($2,000 - $1,700 = $300) when sold (January 3) is disallowed under the wash sale rule.

Reference: 15.5.6.3 in the License Exam Manual

Question #42 of 214

Question ID: 607252

Your customer has experienced $7,500 in capital losses this year. He has realized $2,000 in capital gains and has $65,000 adjusted gross income. How much of his loss will he be able to carry forward to next year?

- ✗ **A)** He may not carry any of this loss forward.
- ✗ **B)** $4,500.
- ✗ **C)** $5,500.
- ✓ **D)** $2,500.

Explanation

He will first offset his $2,000 in capital gains, leaving $5,500 in losses. He next offsets $3,000 in adjusted gross income, leaving $2,500 in losses to carry forward to next year. Provided the loss is offset to the maximum each year, there is no limit to how long losses may be carried forward.

Reference: 15.5.6.1.3 in the License Exam Manual

Question #43 of 214

Question ID: 607117

In recommending securities to customers, a FINRA member firm must do which of the following?

I. Guarantee that future performance will match or exceed past performance.
II. Have a suitable basis for recommendations.
III. Disclose or offer to disclose supporting documentation.
IV. Offer to reimburse execution costs associated with recommendations.

- ✗ **A)** I and IV.
- ✗ **B)** I and III.
- ✗ **C)** II and IV.
- ✓ **D)** II and III.

Explanation

Under the Conduct Rules, a FINRA member firm recommending securities to customers must not make future performance or reimbursement guarantees, must have a suitable basis for its recommendation, and must disclose or offer to disclose supporting documentation.

Reference: 15.1.3 in the License Exam Manual

Question #44 of 214

Question ID: 607138

As a registered representative, if you are assigned to an existing account that was previously handled by another registered representative who has since left your firm, which of the following actions should you take first?

- ✗ **A)** Require the customer to sign a trading authorization, naming you as the party with authority.
- ✗ **B)** Liquidate the portfolio for immediate reinvestment in stocks you are currently recommending.
- ✗ **C)** Suggest the customer buy one of the stocks that you are currently recommending.
- ✓ **D)** Verify the account information.

Explanation

The first action to take would be to verify and update the customer's information in order to make suitable investment recommendations.

Reference: 15.2.1 in the License Exam Manual

Question #45 of 214

Question ID: 721483

Your new client lists income as the primary investment objective for an account with your broker dealer. Which of the following investments would NOT be suitable?

- ✗ **A)** Corporate debt securities
- ✗ **B)** Ginnie Mae (GNMA) government securities
- ✗ **C)** Corporate preferred shares
- ✓ **D)** Zero coupon bonds

Explanation

Zero coupon bonds make no payments until maturity and therefore would not be suitable investments for those with an income objective. Typically, preferred shares because of the fixed dividend they pay, and corporate or government securities making interest payments would be suitable investments to meet an income objective.

Reference: 15.2.2.7 in the License Exam Manual

Question #46 of 214

Question ID: 607157

Reinvestment risk is the chance that, after purchasing a bond, interest rates:

- ✓ **A)** fall.
- ✗ **B)** rise.
- ✗ **C)** remain stable.
- ✗ **D)** become volatile.

Explanation

Reinvestment risk is the danger that after purchasing a bond, interest rates will fall. This means that the fixed interest payments received over the remaining life of the bond will be reinvested at lower rates. The good news is that the price of the bond has probably risen due to falling rates.

Reference: 15.3.2.5 in the License Exam Manual

Question #47 of 214

Question ID: 607210

A customer has $12,000 of capital gains, $15,000 of capital losses, and $50,000 adjusted gross income. How much unused loss is carried forward to the following tax year?

- ✗ **A)** $12,000.
- ✗ **B)** $15,000.
- ✗ **C)** $3,000.
- ✓ **D)** $0.

Explanation

After netting capital gain and losses, the customer has a net capital loss of $3,000. Since $3,000 of net losses can be deducted from income in any single tax year, there is no carry forward.

Reference: 15.5.6.1.3 in the License Exam Manual

Question #48 of 214

Question ID: 607218

If a father makes a gift of securities to his 10-year-old daughter, gift taxes would be based on the:

- ✗ **A)** cost of the securities.
- ✗ **B)** market value of the securities as of April 15 of the year in which the gift is made.
- ✗ **C)** market value of the securities as of December 31 of the year in which the gift is made.
- ✓ **D)** market value of the securities on the date of gift.

Explanation

If a gift tax is due, it is paid by the donor and based on the gift's value on the date it is given.

Reference: 15.5.9.2.1 in the License Exam Manual

Question #49 of 214

Question ID: 607185

A customer has the following municipal bonds in his portfolio:

A-rated, New York State GO 6½, 6-1-12
Baa-rated, M.T.A. (NY) 7½, 7-1-16
Aaa-rated, Buffalo, NY 5%, 2-1-20

The portfolio is diversified in all of the following EXCEPT by:

- ✗ **A)** rating.
- ✗ **B)** purpose.
- ✗ **C)** issuer.
- ✓ **D)** geography.

Explanation

While the issuers, ratings, coupons, and purposes are different for all three bonds, they were all issued within the same state.

Reference: 15.4.1.1 in the License Exam Manual

Question #50 of 214

Question ID: 607186

A client who is a manager of a pension plan has recently liquidated approximately $1 million in securities and now has only cash and cash equivalents in the account. This client's outlook concerning the market is:

- ✓ **A)** bearish.
- ✗ **B)** bullish.
- ✗ **C)** unknown.
- ✗ **D)** neutral.

Explanation

Since the investor has moved all assets into cash or cash equivalents, the investor must expect a bear market and is taking this action in an attempt to protect against incurring losses from the anticipated market decline.

Reference: 15.4.2 in the License Exam Manual

Question #51 of 214

Question ID: 607111

If a registered representative wants to share in the profit or loss of a customer's account, all of the following statements are true EXCEPT:

- ✗ **A)** the account must be approved by a principal.
- ✗ **B)** sharing is permitted without regard to the proportion contributed if there is an immediate family relationship between the parties.
- ✓ **C)** FINRA must be notified in writing.
- ✗ **D)** sharing is permitted only in proportion to the capital contributed by each party.

Explanation

All accounts must be approved by a principal, but FINRA is never notified regarding the opening of accounts. In a joint account involving a customer and a registered representative, profit and loss must be shared in proportion to the capital contributed by each party. The proportionate test does not apply if there is an immediate family relationship between the two.

Reference: 15.1.3.7 in the License Exam Manual

Question #52 of 214

Question ID: 607267

An investor in the 28% tax bracket has a $5,000 loss after netting all capital gains and losses realized. How much may the investor deduct from income that year?

- ✗ **A)** $0.
- ✗ **B)** $2,500.
- ✓ **C)** $3,000.
- ✗ **D)** $5,000.

Explanation

The maximum deduction of net capital losses against other income in any one year is $3,000; any remaining loss can be carried forward into the next year.

Reference: 15.5.4 in the License Exam Manual

Question #53 of 214

Question ID: 607161

If a customer is concerned about interest rate risk, which of the following securities is *least* appropriate?

- ✗ **A)** Treasury bills.
- ✗ **B)** 5-year corporate bonds.
- ✗ **C)** 10-year corporate bonds.
- ✓ **D)** 25-year municipal bonds.

Explanation

Interest rate risk is the danger that interest rates will rise and adversely affect a bond's price. This risk is greatest for long-term bonds; short-term debt securities are affected the least if interest rates change.

Reference: 15.3.2.4 in the License Exam Manual

Question #54 of 214

Question ID: 607247

Several years ago, one of your customers bought an OID municipal bond at $960. The bond has now matured. For federal income tax purposes, the discount is:

- ✗ **A)** taxed at maturity as ordinary income.
- ✓ **B)** tax free.
- ✗ **C)** taxed each year as ordinary income.
- ✗ **D)** taxed as a long-term capital gain.

Explanation

When buying an original issue discount (OID) municipal bond, the discount must be accreted each year and treated as interest income. Because interest income from a municipal bond is tax free at the federal level, the discount is not taxed if the bond is held to maturity. If the customer had purchased a discount in the secondary market, the discount would have been accreted and taxed as ordinary income.

Reference: 15.5.7.2 in the License Exam Manual

Question #55 of 214

Question ID: 607235

Short against the box is a strategy associated with:

- ✗ **A)** avoiding the locate requirement when selling stock short.
- ✗ **B)** designating one tax ID number on a joint account for tax purposes.
- ✓ **C)** deferring capital gains.
- ✗ **D)** hedging short stock positions with options.

Explanation

Selling short against the box is a strategy that is used to lock in a capital gain that will be deferred into a later tax period. For the deferral to be allowed, the IRS requires certain criteria to be met.

Reference: 15.5.9.4 in the License Exam Manual

Question #56 of 214

Question ID: 607176

Which of the following are likely to have a low beta?

- ✗ **A)** Software stocks.
- ✗ **B)** Aerospace stocks.
- ✓ **C)** Public utility stocks.
- ✗ **D)** Technology stocks.

Explanation

Public utility stocks tend to have low betas as do other defensive stocks. Technology, aerospace, and software stocks tend to have high betas.

Reference: 15.3.3.1 in the License Exam Manual

Question #57 of 214

Question ID: 607222

If a municipal bond is purchased at a discount which of the following is TRUE?

- ✗ **A)** The discount is accreted and decreases cost basis each year until maturity.
- ✗ **B)** The discount is amortized and increases cost basis each year until maturity.
- ✓ **C)** The discount is accreted and increases cost basis each year until maturity.
- ✗ **D)** The discount is amortized and decreases cost basis each year until maturity.

Explanation

When a municipal bond is purchased at a discount the amount of the discount is accreted. Accretion is the process of adjusting the cost basis each year upwards, until maturity. At maturity the cost basis will equal PAR.

Reference: 15.5.7.2 in the License Exam Manual

Question #58 of 214

Question ID: 607143

An investor diversifying a corporate bond portfolio does NOT consider:

- ✗ **A)** quality.
- ✗ **B)** issuer.
- ✓ **C)** domicile of the investor.
- ✗ **D)** maturity.

Explanation

Domicile, or geographic location of the investor, is not relevant in diversifying a corporate bond portfolio. For example, it is irrelevant if GM the client is located in Michigan or New Jersey. This could be a factor for municipal bond investors due to the possibility of avoiding state income tax. A corporate bond portfolio can be diversified by issuer, quality (rating), domicile of the issuer and maturity.

Reference: 15.2.2.5 in the License Exam Manual

Question #59 of 214

Question ID: 721491

BAKE-ALL, a U.S. manufacturing corporation, has purchased shares of stock in RE-FORM, a U.S. corporation that refines raw materials. RE-FORM pays a dividend to its shareholders. For BAKE-ALL corporation, taxes will be due on what percentage of the dividends received from RE-FORM?

- ✗ **A)** 0% (all dividends received are tax free)
- ✗ **B)** 100%
- ✗ **C)** 70%

✓ **D)** 30%

Explanation

When a U.S. corporation receives dividends from another U.S. corporation it has invested in, 70% of the dividends received are excluded from taxation (tax free). Therefore, it is the remaining 30% of the dividends received that are taxable.

Reference: 15.5.11.1 in the License Exam Manual

Question #60 of 214

Question ID: 607211

If a customer buys a new issue municipal bond at a discount in the primary market, which of the following statements are TRUE?

I. The discount must be accreted.
II. The discount may not be accreted.
III. At maturity, there is a capital gain.
IV. At maturity, there is no capital gain.

✗ **A)** I and III.
✗ **B)** II and IV.
✗ **C)** II and III.
✓ **D)** I and IV.

Explanation

If a new issue municipal bond is bought at a discount in the primary market, the discount must be accreted. The accretion is considered interest income, and therefore is not taxable.

Reference: 15.5.7.2 in the License Exam Manual

Question #61 of 214

Question ID: 607121

The term "churning" refers to:

✗ **A)** repeatedly purchasing stock in order to keep the price up.
✓ **B)** entering more transactions than necessary, solely for the purpose of generating commissions.
✗ **C)** purchasing calls on a particular stock for your own account before entering a large customer order for the stock.
✗ **D)** repeatedly selling a stock short in order to prevent a price rise.

Explanation

Unnecessary transactions entered into for the purpose of generating commissions constitute churning. A charge of churning can result from both excessive number and excessive size of transactions.

Reference: 15.1.3.1 in the License Exam Manual

Question #62 of 214

Question ID: 607221

A customer buys a new issue municipal bond at a discount. If held to maturity, the amount of the discount is:

✗ **A)** accreted and taxed as ordinary income.
✗ **B)** taxed as a short-term capital gain.
✗ **C)** taxed as a long-term capital gain.
✓ **D)** accreted and is not taxed.

Explanation

Original issue discounts are accreted, which allows for a step-up in cost basis. Accretion on original issue discount municipal bonds is not taxed.

Reference: 15.5.7.2 in the License Exam Manual

Question #63 of 214

Question ID: 607228

If a customer owns a $10,000 8% U.S. Treasury Bond and she is in the 28% federal tax bracket and a 2-½% state tax bracket, what amount of tax will she pay on the income received from the bond?

- ✗ **A)** $20.
- ✗ **B)** $100.
- ✓ **C)** $224.
- ✗ **D)** $80.

Explanation

Interest on U.S. Treasury bonds is taxable at the federal level only; $800 of interest taxed at 28% = $224.

Reference: 15.5.4.1.1 in the License Exam Manual

Question #64 of 214

Question ID: 607130

If an employee of an NYSE member wants to take a second job, which of the following statements is TRUE?

- ✓ **A)** Prior written notice to the member firm is required
- ✗ **B)** Prior notice to the NYSE is required
- ✗ **C)** Prior permission of the NYSE is required
- ✗ **D)** Prior written notice to the member firm and prior written permission to the employee is required

Explanation

Prior written notice to the member firm from the employee is required. While no prior written permission of the firm is required, the member firm does have the right to reject or restrict and outside affiliations if they feel a conflict of interest exists.

Reference: 15.1.2.2 in the License Exam Manual

Question #65 of 214

Question ID: 607198

All of the following statements regarding dollar-cost averaging are correct EXCEPT:

- ✗ **A)** dollar-cost averaging is the investment of a fixed amount of money each period.
- ✗ **B)** an employee stock purchase plan (ESPP) is one way to use dollar-cost averaging.
- ✗ **C)** dollar-cost averaging is a passive investment strategy.
- ✓ **D)** dollar-cost averaging decreases the risk of loss.

Explanation

Dollar-cost averaging is a passive investment strategy using a fixed dollar amount to purchase shares no matter what the price is. The fixed dollar amount buys more shares when the price is lower and fewer shares when the price is higher. While this strategy can lower the average cost per share over time it does not assure profitability nor does it decrease the risk of loss.

Reference: 15.4.1.2 in the License Exam Manual

Question #66 of 214

Question ID: 721488

Alternative minimum tax (AMT):

- ✗ **A)** is assessed against all self-employed individuals.
- ✓ **B)** is assessed against high annual income earners and disallows some deductions and exemptions used to calculate adjusted gross income.
- ✗ **C)** is assessed against low annual income earners and allows special deductions for them to be taken.
- ✗ **D)** is assessed against high annual income earners and gives them special deductions to take that lower income earners do not get.

Explanation

The alternative minimum tax (AMT) is assessed against high annual income earners. When calculating adjusted gross income some deductions and exemptions are disallowed resulting in a higher taxable adjusted gross income (AGI).

Reference: 15.5.10 in the License Exam Manual

Question #67 of 214

Question ID: 803451

Which of the following carries the least market risk?

- ✓ **A)** Savings accounts
- ✗ **B)** Treasury bills
- ✗ **C)** Common stock
- ✗ **D)** Treasury bonds

Explanation

Savings accounts carry no market risk, which, by definition, is the risk that an investor will experience losses due to day-to-day fluctuations in the prices of securities bought and sold in the market.

Reference: 15.3.2.7 in the License Exam Manual

Question #68 of 214

Question ID: 607163

Your client is interested in a direct participation program (DPP) limited partnership. Which of the following two are most likely to factor into a discussion on suitability of such an investment?

I. Beta.
II. Liquidity.
III. Duration.
IV. Age.

- ✓ **A)** II and IV.
- ✗ **B)** II and III.
- ✗ **C)** I and III.
- ✗ **D)** I and IV.

Explanation

The key here is to recognize that with DPPs, the customer's age is a relevant consideration in determining suitability. DPPs are long-term and illiquid. For example, it is unlikely that DPPs would be suitable for a customer near retirement age, regardless of the customer's financial situation. Beta, having to do with measuring an investment's volatility as related to the overall market, and duration having to with bonds are not factors that would be associated with DPPs.

Reference: 15.3.2.9 in the License Exam Manual

Question #69 of 214

Question ID: 607261

A highly compensated customer owns 200 shares of Datawaq. He bought it 20 years ago, and it is now trading at 90. If he donates the stock to a nonprofit corporation, how much can he claim as a tax deduction for this donation?

- ✗ **A)** $0.
- ✗ **B)** $12,000.
- ✓ **C)** $18,000.
- ✗ **D)** $6,000.

Explanation

Securities can be gifted to charity and deducted at their fair market value, as long as they have been held more than 1 year. The fair market value of the deduction allowed for 200 shares is 200 multiplied by the current market price of the stock, or $18,000.

Reference: 15.5.9.1.1 in the License Exam Manual

Question #70 of 214

Question ID: 607297

Tax preference items are used for the purpose of computing the alternative minimum tax. They include:

I. excess intangible drilling costs (wages, fuel, repairs).
II. accelerated depreciation.
III. percentage depletion in excess of basis.

- ✗ **A)** I and II.
- ✗ **B)** I and III.
- ✓ **C)** I, II and III.
- ✗ **D)** II and III.

Explanation

All of these. are tax preference items. Note that straight line depreciation is not a tax preference item.

Reference: 15.5.10.1 in the License Exam Manual

Question #71 of 214

Question ID: 607275

Paying a premium of $10 per bond, Ms. Tracey Pringle bought 10 municipal bonds with 20 years to maturity. Ten years later, she sold the bonds for 103. For tax purposes, she has a:

- ✓ **A)** $250 gain.
- ✗ **B)** $300 loss.
- ✗ **C)** $200 gain.
- ✗ **D)** $200 loss.

Explanation

The cost per bond is $1,010. The amortization amount each year is 10/20 years, which equals $.50 per year. $.50 per year × 10 years = $5 per bond. After 10 years, the adjusted cost basis is $1,005 per bond. She sells the bonds for $1,030 per bond. $1,030 − $1,005 = $25 per bond 25 × 10 = $250 gain.

Reference: 15.5.7.1 in the License Exam Manual

Question #72 of 214

Question ID: 607158

Which of the following statements is NOT true?

- ✓ **A)** Beta is a measure of a security's deviation from its historical average returns.
- ✗ **B)** A stock with a beta of .8 will move 20% less than the market.
- ✗ **C)** A stock with a beta of 1.2 will move 20% more than the market.
- ✗ **D)** Beta is a volatility measure of a security compared with the overall market.

Explanation

A measure of a security's deviation from its historical average returns is the security's standard deviation. Beta measures a security's volatility in relation to the overall market. Stocks with a beta greater than 1 are more volatile than the market and stocks with a beta less than 1 are less volatile than the market.

Reference: 15.3.3.1 in the License Exam Manual

Question #73 of 214

Question ID: 607241

On January 18, your customer sold 500 shares of MNO for a loss of $5 per share. If on March 1 he bought 3 MNO calls, how much of the loss could he declare for tax purposes?

- ✗ **A)** $1,500.

✓ **B)** $2,500.
✗ **C)** He may not declare any loss.
✗ **D)** $1,000.

Explanation

Since the purchase of the calls took place more than 30 days after the sale, the transaction is not a wash sale. He may therefore declare the entire $2,500 as a loss.

Reference: 15.5.6.3 in the License Exam Manual

Question #74 of 214

Question ID: 607300

If a customer buys a Mt. Vernon Port Authority municipal bond in the secondary market at 109 and holds the bond to maturity what are the tax consequences?

✗ **A)** Capital loss of $9.
✓ **B)** No capital gain or loss.
✗ **C)** Capital loss of $90.
✗ **D)** Capital gain of $9.

Explanation

The investor's cost basis of bonds purchased at a premium is adjusted by amortization of the premium. In this case, there is a $90 premium that will have been completely amortized at maturity. At maturity the adjusted cost basis equals the face value and no loss or gain is realized.

Reference: 15.5.7.1 in the License Exam Manual

Question #75 of 214

Question ID: 607139

Which of the following activities are a registered representative's responsibilities?
I. Determining the suitability of various investments for individual customers.
II. Describing the characteristics and benefits of various securities products.
III. Offering tax advice and assisting customers in completing tax returns.
IV. Personally holding a customer's securities for a future transaction.

✓ **A)** I and II.
✗ **B)** I and III.
✗ **C)** II and IV.
✗ **D)** III and IV.

Explanation

A registered representative, in addition to entering orders, is primarily responsible for determining investments' suitability and for explaining different investments to prospective investors.

Reference: 15.2.1 in the License Exam Manual

Question #76 of 214

Question ID: 607118

When comparing investment alternatives, all of the following must be considered EXCEPT:

✗ **A)** differences in risk exposure between the two companies.
✗ **B)** relative time period of returns on investment.
✓ **C)** state of incorporation of the companies.
✗ **D)** relative after-tax returns, when appropriate.

Explanation

The state of incorporation is generally not a relevant factor when comparing investments.

Reference: 15.1.3 in the License Exam Manual

Question #77 of 214

Question ID: 607195

Which of the following is the *best* example of a passive investment management style?

- ✗ **A)** Investment in small capitalization technology securities.
- ✗ **B)** Value investing.
- ✗ **C)** Use of index funds in conjunction with selecting specific securities in the index to overweight certain sectors.
- ✓ **D)** Exclusive use of index funds.

Explanation

A passive investment style uses index funds because the manager does not believe that returns above the averages can be sustained for any length of time because the market is priced efficiently. Use of index funds in conjunction with specific securities in order to overweight sectors is an active style. Investment in small capitalization technology securities involves actively selecting securities that the manager believes will perform well or better than the market. Value investing involves the active search for securities that are undervalued by the market.

Reference: 15.4.3 in the License Exam Manual

Question #78 of 214

Question ID: 607269

The term for the annual reduction of a municipal bond's cost basis purchased at a premium is:

- ✗ **A)** compound amortization.
- ✓ **B)** straight line amortization.
- ✗ **C)** straight line accretion.
- ✗ **D)** compound accretion.

Explanation

Amortization is the process by which the cost basis of a bond bought at a premium is decreased during the holding period. Because the cost basis is reduced by equal amounts every year, amortization is done on a straight line basis. At maturity, the cost basis has been reduced to par.

Reference: 15.5.7.1 in the License Exam Manual

Question #79 of 214

Question ID: 607184

Which of the following *best* describes the investment characteristics of a high-quality long-term municipal bond?

- ✗ **A)** High inflation risk; high market risk.
- ✗ **B)** Low inflation risk; high market risk.
- ✗ **C)** Low inflation risk; low default risk.
- ✓ **D)** High inflation risk; low default risk.

Explanation

A longer-term bond will be subject to more inflation risk. Since the quality of the bond is high, the level of default risk should be low.

Reference: 15.3.2.1 in the License Exam Manual

Question #80 of 214

Question ID: 607110

All of the following activities in a customer's mutual fund account may be considered a violation of the Conduct Rules EXCEPT:

- ✗ **A)** switching of Class A shares between fund families.
- ✗ **B)** short-term trading in mutual fund shares.
- ✗ **C)** excessive activity in the customer's account.
- ✓ **D)** granting of discretionary authority to a new registered representative.

Explanation

Mutual funds are considered a long-term investment. Thus, switching Class A shares of funds, short-term trading of funds, and excessive activity in a customer's account very likely indicate that the registered representative is churning. There is nothing unlawful about granting discretionary authority to a new registered representative.

Reference: 15.1.3.1 in the License Exam Manual

Question #81 of 214

Question ID: 607311

Regarding the taxation of dividends received from corporate securities, which of the following are TRUE?

I. Nonqualified dividends are taxed at the rate the investor’s ordinary income will be taxed.
II. Nonqualified dividends are not taxed.
III. Qualified dividends are taxed at a maximum rate specified by the IRS and will depend on the investor's income tax bracket.
IV. Qualified dividends are taxed at the rate the investor’s ordinary income will be taxed.

✗ **A)** II and III
✗ **B)** II and IV
✗ **C)** I and IV
✓ **D)** I and III

Explanation

Nonqualified (ordinary) dividends are taxed at the investor’s ordinary income tax rate, while qualified dividends will be taxed at a maximum rate as specified by the IRS. Whether or not the qualified dividends are taxed at the maximum rate or a lower rate depends on the investor's income tax bracket. The higher the investor’s income tax bracket the higher the tax on qualified dividends will be, up to the maximum.

Reference: 15.5.4.2 in the License Exam Manual

Question #82 of 214

Question ID: 607291

A customer bought 100 ABC at 60 in January of 1998. In February 2000, the stock is worth $100 per share and the customer donated it to charity. The consequences are:

I. a $6,000 deduction.
II. a $10,000 deduction.
III. no tax is due on appreciation.
IV. tax is due on appreciation.

✓ **A)** II and III.
✗ **B)** I and III.
✗ **C)** I and IV.
✗ **D)** II and IV.

Explanation

When an investor donates appreciated securities to charity, the investor will receive a tax deduction based on their value as of the donation date. There will be no tax due on the amount of appreciation as long as the stock was held long-term as of the date of the charitable donation.

Reference: 15.5.9.1.1 in the License Exam Manual

Question #83 of 214

Question ID: 607301

A customer is selling inherited stock. The decedent originally paid $50 per share and on the date of the decedent's death, the stock was worth $60 per share. On the day the customer sells the stock, the price per share is $62. What is the investor's cost basis in the stock?

✗ **A)** 50.
✗ **B)** 55.
✓ **C)** 60.
✗ **D)** 62.

Explanation

The IRS allows a step-up in basis for inherited stock. The customer's cost basis is the fair market value of the stock on the date that the decedent died.

Reference: 15.5.9.1.3 in the License Exam Manual

Question #84 of 214

Question ID: 607219

If a customer of your firm receives stock from the estate of her mother, the stock's cost basis in the hands of the customer is the:

- ✗ **A)** original cost of the stock adjusted for any estate taxes paid.
- ✗ **B)** market value at date of distribution to the customer.
- ✓ **C)** market value at date of death.
- ✗ **D)** original cost of the stock.

Explanation

When securities are inherited, the heir receives a cost basis calculated as of the deceased party's date of death.

Reference: 15.5.9.1.3 in the License Exam Manual

Question #85 of 214

Question ID: 607108

Under FINRA rules, a registered representative is permitted to borrow money from a customer:

- ✗ **A)** without restriction.
- ✗ **B)** under no circumstances.
- ✗ **C)** if written notification is given to the firm.
- ✓ **D)** if written notification is given to the firm and the representative receives written approval.

Explanation

Firms are not required to permit lending arrangements between registered representatives and their customers. If they do, they must have procedures in place to monitor such arrangements. If permitted by the firm, the arrangement must fall into one of five permissible categories: the customer is a member of the representative's immediate family; the customer is in the business of lending money; the customer and the representative are both registered with the same firm; the arrangement is based on a personal relationship outside of the customer/representative relationship; or the arrangement is based on a business relationship outside of the customer/representative relationship. If permitted by the firm, the representative must advise the firm in writing of the proposed borrowing, and receive written permission.

Reference: 15.1.3.4 in the License Exam Manual

Question #86 of 214

Question ID: 607304

If an investor is in the highest federal income tax bracket and is subject to the alternative minimum tax, which of the following securities should an agent recommend?

- ✗ **A)** Treasury bond.
- ✗ **B)** Industrial revenue bond.
- ✗ **C)** Corporate bond.
- ✓ **D)** General obligation bond.

Explanation

Municipal bonds are suitable for the portfolio of an investor who is in a high tax bracket because the interest is exempt from federal income tax. A general obligation (GO) bond is a better recommendation than an industrial revenue bond because the interest on industrial revenue bonds is likely subject to the AMT.

Reference: 15.5.10 in the License Exam Manual

Question #87 of 214

Question ID: 607145

If a customer is in a low federal income tax bracket and his main investment objective is current income, which of the following securities should the agent recommend?

- ✗ **A)** City of Milwaukee GO bond.

- ✗ **B)** U.S. government bond.
- ✗ **C)** Zero-coupon bond.
- ✓ **D)** Investment-grade corporate bond.

Explanation

If an investor is in a low-tax bracket any benefit from receiving tax-free municipal bond interest is diminished, making municipal bonds a less suitable investment. Zero-coupon bonds pay no interest until maturity and therefore are not suitable for someone seeking current income. To maximize income, the best recommendation of the choices listed is the corporate bond which offers a higher yield than a government bond with a similar maturity.

Reference: 15.2.2.2 in the License Exam Manual

Question #88 of 214

Question ID: 607165

An investor's portfolio has a beta coefficient of .85. If the overall market declined by 10% over the course of a year, the portfolio's value has likely:

- ✗ **A)** increased by 8.5%.
- ✗ **B)** increased by 10.85%.
- ✗ **C)** decreased by 11.76%.
- ✓ **D)** decreased by 8.5%.

Explanation

A beta coefficient of .85 means that the portfolio is considered to be .85 times as volatile as the overall market. Therefore, if the market declines by 10%, the portfolio with a beta of .85 is likely to decline by only 8.5% (.10 × .85).

Reference: 15.3.3.1 in the License Exam Manual

Question #89 of 214

Question ID: 607200

Your client's investment portfolio is 50% growth stocks, 10% foreign stocks and 40% blue chip stocks. If the client is interested in further diversification which mutual fund would *best* meet that goal?

- ✗ **A)** Aggressive growth fund.
- ✗ **B)** Emerging market fund.
- ✗ **C)** Global equity fund.
- ✓ **D)** Bond fund.

Explanation

All of the current holdings are equities. To further diversify the current portfolio, the bond fund would be the best choice of those given to meet this objective.

Reference: 15.4.1.1 in the License Exam Manual

Question #90 of 214

Question ID: 607296

When determining whether a tax swap of municipal bonds will result in a wash sale, each of the following are considered EXCEPT:

- ✗ **A)** coupon.
- ✗ **B)** issuer.
- ✗ **C)** maturity.
- ✓ **D)** principal amount.

Explanation

In judging whether bonds purchased are substantially identical to bonds sold for a loss, the tax code considers maturity, issuer, and coupon rate. If at least two of the three are different, a wash sale will generally not result.

Reference: 15.5.6.3 in the License Exam Manual

Question #91 of 214

Question ID: 607175

A bond's duration is:

- ✗ **A)** an indication of a bond's yield that ignores its price volatility.
- ✓ **B)** longer for a 10-year bond with a 5% coupon than it is for a 10-year bond with a 10% coupon.
- ✗ **C)** identical to its maturity for an interest-bearing bond.
- ✗ **D)** expressed as a percentage.

Explanation

Duration measures a bond's price volatility by weighting the length of time it takes for a bond's cash flow to pay for itself. If two bonds with differing coupon rates have identical maturities, the one with the lower coupon has the longer duration. The cash flow from an interest-bearing bond makes its duration shorter than its maturity. Bonds with longer duration carry greater price volatility. Duration is expressed in years (time) rather than in percentage.

Reference: 15.3.3.2 in the License Exam Manual

Question #92 of 214

Question ID: 607196

An investment adviser who switches among investment classes based upon anticipated market changes is using a technique known as:

- ✗ **A)** indexing.
- ✗ **B)** value investing.
- ✓ **C)** asset allocation.
- ✗ **D)** dollar cost averaging.

Explanation

A money management strategy that switches among asset classes based upon anticipated market moves is asset allocation. Indexing is a passive strategy that makes no attempt to anticipate market moves. An index strategy reflects an underlying index with the adviser keeping securities in the portfolio in proportion to their weight in the underlying index. Value investing seeks to actively invest in securities that are selling at a discount to their book value and out of favor with the market. Dollar cost averaging is a method of acquiring shares at a lower average cost over time and is not an investment style.

Reference: 15.4.2 in the License Exam Manual

Question #93 of 214

Question ID: 607245

The income from all of the following securities is taxable on the federal, state, and local income tax levels EXCEPT:

- ✗ **A)** corporate BBB bonds.
- ✓ **B)** Treasury bonds.
- ✗ **C)** GNMA certificates.
- ✗ **D)** reinvested mutual fund dividends.

Explanation

The interest on U.S. government securities (such as Treasury bonds) is exempt from state and local income taxes, but not federal income taxes. Dividends (whether reinvested or not), Ginnie Maes, and corporate bonds of all types and/or ratings are taxable on all levels.

Reference: 15.5.4.1.1 in the License Exam Manual

Question #94 of 214

Question ID: 607156

Which of the following statements are TRUE?

I. Systematic risk can be diversified away.
II. Systematic risk cannot be diversified away.
III. Nonsystematic risk can be diversified away.
IV. Nonsystematic risk cannot be diversified away.

✗ **A)** I and III.
✗ **B)** II and IV.
✓ **C)** II and III.
✗ **D)** I and IV.

Explanation

Systematic risk, which affects all investments, cannot be diversified away. Nonsystematic risk, or company risk, can.

Reference: 15.3.2.7 in the License Exam Manual

Question #95 of 214

Question ID: 607215

If a customer buys a corporate bond at a discount in the secondary market, which of the following statements are TRUE if the bond is held to maturity?

I. The discount is taxable as ordinary income.
II. The discount is taxable as a long-term capital gain.
III. The interest income is taxable as ordinary income.
IV. The interest income is not taxable.

✗ **A)** II and IV.
✗ **B)** II and III.
✓ **C)** I and III.
✗ **D)** I and IV.

Explanation

The discount on a corporate bond purchased in the secondary market must be accreted and is taxable as ordinary income, not as a capital gain. Furthermore, the interest income on corporate bonds is fully taxable.

Reference: 15.5.7.2 in the License Exam Manual

Question #96 of 214

Question ID: 607289

A customer purchases a corporate bond at 102, paying accrued interest of $50. If he elects not to amortize the premium, his cost basis for tax purposes is:

✗ **A)** 97.
✓ **B)** 102.
✗ **C)** 100.
✗ **D)** 107.

Explanation

While most investors elect to amortize premiums, they are not required to do so. Here, the cost basis remains at the original purchase price: 102.

Reference: 15.5.8 in the License Exam Manual

Question #97 of 214

Question ID: 607206

For tax purposes, cash dividends are taxable to stockholders as of the:

✓ **A)** payable date.
✗ **B)** declaration date.
✗ **C)** ex-date.
✗ **D)** record date.

Explanation

Cash dividends are not taxable until paid.

Reference: 15.5.5 in the License Exam Manual

Question #98 of 214

Question ID: 607285

A customer buys 5 municipal bonds maturing in 20 years for 104. If he sells the bonds after 10 years at 103, the customer has a:

- ✗ **A)** $100 capital gain.
- ✗ **B)** $50 capital loss.
- ✗ **C)** $100 capital loss.
- ✓ **D)** $50 capital gain.

Explanation

The premium on the municipal bonds must be amortized. The bonds were bought at 104 and therefore each bond has $40 in premiums (5 bonds X $40 = $200 premium to be amortized over 20 years). This means the cost basis of the bonds ($5,200) decreases by $10 a year ($200 / 20 years = $10). After 10 years amortization, $100 has been amortized (10 years × $10 per year), and the customer has an adjusted cost basis of $5,100. If the bonds are sold for 103 ($5,150), the customer has a $50 taxable capital gain.

Reference: 15.5.7.1 in the License Exam Manual

Question #99 of 214

Question ID: 607189

If an investor practices value investing, which of the following stock types is he *least* likely to purchase?

- ✗ **A)** A stock that is presently selling for two-thirds of net current assets.
- ✗ **B)** A stock that has exhibited a high dividend yield in the past.
- ✓ **C)** A stock with an above-average price-to-earnings ratio.
- ✗ **D)** A stock with a low price-to-earnings ratio.

Explanation

A growth investor looks for stocks with above-average price-to-earnings ratios. Conversely, a value investor focuses on stocks with low PE ratios, a low price-to-book value, and historically high dividend yields.

Reference: 15.4.3.2 in the License Exam Manual

Question #100 of 214

Question ID: 607272

A municipal bond originally issued at 90 with a 10-year maturity will have a compound accreted value (CAV) after 5 years equal to:

- ✓ **A)** 95.
- ✗ **B)** 5.
- ✗ **C)** 10.
- ✗ **D)** 100.

Explanation

CAV is the cost basis of the bond, in this case, after 5 years accretion. There are 10 points to accrete (the difference between the issue price of 90 and par) over 10 years. One point each year will be added, so after 5 years, the adjusted cost basis will be 90 + 5, or 95.

Reference: 15.5.7.2 in the License Exam Manual

Question #101 of 214

Question ID: 607188

A new customer asks her registered representative to recommend undervalued or out-of-favor securities with relatively low prices. This portfolio management strategy is known as:

- ✗ **A)** tactical.
- ✗ **B)** growth.
- ✓ **C)** value.

✗ **D)** passive.

Explanation

Value investing is the strategy of selecting stocks that trade for less than their book value. Value investors actively seek stocks of companies with sound financial statements that they believe the market has undervalued.

Reference: 15.4.3.2 in the License Exam Manual

Question #102 of 214

Question ID: 729914

Regarding a bond's duration, which measures the time it takes for a bond to pay for itself, which of the following statements is TRUE?

✗ **A)** For interest bearing bonds duration is greater than the bonds maturity
✓ **B)** A zero coupon bonds duration is equal to its maturity
✗ **C)** A zero coupon bonds duration is less than the bonds maturity
✗ **D)** Interest bearing bonds have no measurable bond duration

Explanation

A zero coupon bonds duration is equal to its maturity. For interest bearing bonds duration is less than the bond's maturity.

Reference: 15.3.3.2 in the License Exam Manual

Question #103 of 214

Question ID: 607120

If a customer, while out of town, receives a margin call for securities purchased a day earlier, which of the following actions would be appropriate?

I. The customer overnights a personal check to cover the call.
II. The broker servicing the account writes a personal check to cover the call.
III. The brokerage firm transfers the position to its trading account until the customer returns.
IV. The customer uses a wire transfer of funds to cover the call.

✗ **A)** II and IV.
✗ **B)** II and III.
✓ **C)** I and IV.
✗ **D)** I and III.

Explanation

Personal checks as well as wire transfers can be used to meet the call, but a broker may never loan money to a customer. Furthermore, the brokerage firm may never transfer a customer's position to its proprietary trading account pending the customer's return to satisfy a customer's margin call.

Reference: 15.1.3.4 in the License Exam Manual

Question #104 of 214

Question ID: 607256

If your customer bought an original-issue discount bond from the Mt. Vernon Port Authority, how is the discount on this bond taxed?

✗ **A)** Amortized during the life of the bond and not taxed.
✗ **B)** As ordinary income.
✓ **C)** Accreted during the life of the bond and not taxed.
✗ **D)** As capital gains.

Explanation

Under IRS rules, an owner of an original-issue municipal discount bond must adjust the bond's cost basis by accreting the discount over the life of the bond. The accretion is not taxed.

Reference: 15.5.7.2 in the License Exam Manual

Question #105 of 214

Question ID: 607179

A wealthy client owns a large percentage of a thinly traded common stock. When this client wants to sell a major portion of his securities, he will immediately face:

- ✗ **A)** credit risk.
- ✓ **B)** marketability risk.
- ✗ **C)** market risk.
- ✗ **D)** interest rate risk.

Explanation

It is difficult to sell a large block of securities in a thinly traded stock without a substantial discount to market price. This is known as liquidity or marketability risk.

Reference: 15.3.2.9 in the License Exam Manual

Question #106 of 214

Question ID: 607257

A customer owns 10M of 7% U.S. Treasury bonds. He is in the 28% federal tax bracket and the 10% state tax bracket. What is his annual tax liability on these bonds?

- ✗ **A)** $266.
- ✗ **B)** $98.
- ✓ **C)** $196.
- ✗ **D)** $70.

Explanation

His tax liability is as follows: $1,000 × 7% = $70 annual interest per bond; $70 × 10 = $700 annual interest, which is taxable only by the federal government; $700 × 28% = a $196 tax liability.

Reference: 15.5.4.1.1 in the License Exam Manual

Question #107 of 214

Question ID: 607262

If a married couple establishes a JTWROS account with a balance of $1 million and the wife dies, what is the husband's estate tax liability?

- ✗ **A)** He pays federal and state taxes on the entire balance.
- ✓ **B)** He pays no estate tax.
- ✗ **C)** He pays federal and state taxes on $500,000.
- ✗ **D)** He pays federal taxes only on $500,000.

Explanation

Establishing a joint tenants with right of survivorship account allows for the transfer of assets to the survivor upon death. The surviving spouse is not taxed on assets transferred in this manner because under current tax law, there is an unlimited marital deduction.

Reference: 15.5.9.2.4 in the License Exam Manual

Question #108 of 214

Question ID: 607240

KLP Corporation has extensive investments in the stocks and bonds of other corporations. Its portfolio income this year amounts to $700,000 in interest income from bonds and $400,000 in dividend income from common and preferred stock. On how much of its portfolio income must it pay taxes this year?

- ✗ **A)** $120,000.
- ✗ **B)** $300,000.
- ✗ **C)** $1.1 million.
- ✓ **D)** $820,000.

Explanation

The corporate exclusion is 70% of dividend income; therefore, KLP must pay taxes on all $700,000 of its interest income, but only 30% (or $120,000) of its dividend income, for a total of $820,000.

Reference: 15.5.11.1 in the License Exam Manual

Question #109 of 214

Question ID: 607194

Institutional managers are moving to increase their cash position. This action would be viewed as:

- ✗ **A)** neutral.
- ✗ **B)** neutral bull.
- ✗ **C)** bullish.
- ✓ **D)** bearish.

Explanation

When investment managers liquidate securities to increase their cash positions, stock prices are likely to fall.

Reference: 15.4.2 in the License Exam Manual

Question #110 of 214

Question ID: 786345

A registered representative employed by a broker dealer must notify the employer in writing and be permitted by the employer to do all of the following EXCEPT

- ✓ **A)** own a small financial interest in a publicly traded retail company
- ✗ **B)** serve as an officer of another business organization
- ✗ **C)** own an interest in any other organization engaged in the securities business
- ✗ **D)** take an evening job as a bartender

Explanation

Registered representatives must notify their employer in writing to engage in any other business, serve as an officer or director of another business organization, or own any interests in a privately held financial services company. While written permission from the firm is not required, a firm may disallow the activity. In this regard, when a firm chooses to not disallow the activity, they are in effect, permitting it. Publicly held shares do not require consent provided there is no control relationship (defined as 10% or more ownership).

Reference: 15.1.2.2 in the License Exam Manual

Question #111 of 214

Question ID: 607192

A customer pursuing income using a defensive investment strategy while avoiding volatility would be *most* interested in:

- ✓ **A)** short-term government bonds.
- ✗ **B)** growth stocks.
- ✗ **C)** high yield corporate debt.
- ✗ **D)** limited partnerships.

Explanation

Remember to take all investor characteristics into account. Short-term government bonds will produce for the customer safe income with little price volatility.

Reference: 15.4 in the License Exam Manual

Question #112 of 214

Question ID: 607268

A customer buys a newly issued municipal zero-coupon original issue discount bond for 85. If the bond is held until maturity, the tax consequence:

- ✗ **A)** is $150 loss.
- ✓ **B)** is $0.
- ✗ **C)** is $150 gain.

✗ **D)** cannot be calculated from the information given.

Explanation

Municipal original issue discount bonds must be accreted. At maturity, the entire discount will have been accreted, and the cost basis will be equal to the par value. No gain or loss will occur at maturity.

Reference: 15.5.7.2 in the License Exam Manual

Question #113 of 214

Question ID: 607226

A customer buys 100 XYZ at $30. Two years later, with the stock trading at $70, the customer makes a gift of the securities to his son. Which of the following statements are TRUE?

I. For gift-tax purposes, the value of the gift is $3,000.
II. For gift-tax purposes, the value of the gift is $7,000.
III. The son's cost basis on the stock is $3,000.
IV. The son's cost basis on the stock is $7,000.

✓ **A)** II and III.
✗ **B)** I and III.
✗ **C)** II and IV.
✗ **D)** I and IV.

Explanation

When making a gift of securities, the market value at date of gift is used to determine if any gift taxes are due. However, when making a noncharitable gift of securities, the donor's cost basis is passed to the recipient.

Reference: 15.5.9.1.2 in the License Exam Manual

Question #114 of 214

Question ID: 607238

At year's end, your client reports $12,000 in capital gains and $20,000 in capital losses. The net effect of this on his taxes would be:

✗ **A)** a $3,000 deduction from ordinary income with a $2,500 loss carry-forward.
✗ **B)** a $4,000 deduction from ordinary income with a $4,000 loss carry-forward.
✗ **C)** an $8,000 deduction from ordinary income.
✓ **D)** a $3,000 deduction from ordinary income with a $5,000 loss carry-forward.

Explanation

The customer may offset all of the gains with the losses. This leaves a new loss of $8,000. Since the maximum net capital loss that may be deducted against ordinary income is $3,000 per year, we take off the $3,000 and have a carry-forward of the balance ($5,000).

Reference: 15.5.6.1.3 in the License Exam Manual

Question #115 of 214

Question ID: 607299

A customer purchases a municipal bond in the secondary market at 84 and he holds the bond to maturity. Since the customer must accrete the discount, what are the tax consequences at maturity?

✗ **A)** Capital gain of $16.
✗ **B)** Capital loss of $16.
✗ **C)** Capital gain of $160.
✓ **D)** No capital gain or loss.

Explanation

When a municipal bond is purchased in the secondary market at a discount, the discount must be accreted for cost-basis purposes. Note that the accretion on a discount municipal purchased in the secondary market is taxable as ordinary income. At maturity, the customer's cost basis has been accreted to par. Therefore, there is no reported gain or loss on redemption.

Reference: 15.5.7.2 in the License Exam Manual

Question #116 of 214

Question ID: 607282

A customer sells short 100 shares of GHI on February 26, 2000, at $40 per share. He covers his short on March 10, 2002, at $32 per share. For tax purposes, the $800 will be treated as

- ✗ **A)** ordinary income in 2002
- ✗ **B)** a capital loss in 2000
- ✗ **C)** a capital gain in 2000
- ✓ **D)** a capital gain in 2002

Explanation

Investors profit on short positions when the market value of the stock falls. In this situation, the market value of the stock has fallen from 40 to 32 for a profit of $8 per share. This gain of $800 (100 shares) is reportable when the shares are delivered to cover the short position. Uncovered short sales are reported as short-term gains and losses no matter how long the holding period.

Reference: 15.5.6.1.1 in the License Exam Manual

Question #117 of 214

Question ID: 607255

Which of the following taxes is considered regressive?

- ✓ **A)** Sales.
- ✗ **B)** Inheritance.
- ✗ **C)** Income.
- ✗ **D)** Estate.

Explanation

Sales tax is considered regressive because the rate remains constant irrespective of the amount being taxed. Income taxes, for example, take more from a person with a high income than from a person with a low income.

Reference: 15.5.1 in the License Exam Manual

Question #118 of 214

Question ID: 607216

Income from all of the following is partially exempt to a corporate investor EXCEPT:

- ✗ **A)** income from preferred stock mutual funds.
- ✓ **B)** income from convertible bonds.
- ✗ **C)** income from preferred stock.
- ✗ **D)** income from common stock.

Explanation

Seventy percent of dividend income received from investments in common stock and preferred stock is excluded from taxation for a corporate investor. This exclusion applies to dividends from mutual funds where all of the portfolio securities are preferred or common stock.

Reference: 15.5.11.1 in the License Exam Manual

Question #119 of 214

Question ID: 607298

A customer purchases $100,000 of original issue discount municipal bonds. How will this trade be considered for tax purposes when the bonds mature?

- ✗ **A)** Fully taxable on capital gain.

- ✗ **B)** Taxable as long-term gain.
- ✗ **C)** Taxable as short-term gain.
- ✓ **D)** No capital gain.

Explanation

Original issue discount profit at maturity is treated as part of the tax-free interest on a municipal bond. However, for a municipal bond bought at a discount in the secondary market, the discount is considered ordinary income subject to tax.

Reference: 15.5.7.2 in the License Exam Manual

Question #120 of 214

Question ID: 607178

In a rising market, which of the following is *least* volatile?

- ✗ **A)** A stock with an alpha of 0.5.
- ✗ **B)** A stock with an alpha of 2.0.
- ✓ **C)** A stock with a beta of 0.5.
- ✗ **D)** A stock with a beta of 2.0.

Explanation

Beta is a measure of a stock's volatility relative to the overall market, as measured by the S&P 500. A stock with a beta of 2.0 will move twice as fast as the overall market, while a stock with a beta of 0.5 will move half as fast as the overall market.

Reference: 15.3.3.1 in the License Exam Manual

Question #121 of 214

Question ID: 607173

The risk of a bond decreasing in value during periods of inflation is known as:

- ✓ **A)** interest rate risk.
- ✗ **B)** credit risk.
- ✗ **C)** reinvestment risk.
- ✗ **D)** marketability risk.

Explanation

Interest rate risk is the possibility that interest rates might rise, causing bond prices to fall. Periods of inflation are accompanied by rising interest rates.

Reference: 15.3.2.4 in the License Exam Manual

Question #122 of 214

Question ID: 786032

An investor has accumulated 3000 shares of XYZ common stock over several years via several separate purchases. If the investor sells 1000 shares and chooses to identify the specific shares sold for tax purposes, he must

- ✓ **A)** notify the broker dealer who handled the sell transaction within 2 business days of the trade date
- ✗ **B)** identify the specific shares to be sold prior to the transaction
- ✗ **C)** notify the IRS no later than the last business day of the month the trade occurred in
- ✗ **D)** notify FINRA on the trade date

Explanation

The IRS mandates that when an investor wishes to identify the specific shares sold for tax purposes the broker dealer who handled the sell transaction must be notified within 2 business days of the sale. For stock transactions this means by the settlement date.

Reference: 15.5.6.2 in the License Exam Manual

Question #123 of 214

Question ID: 607248

A customer buys a municipal bond in the secondary market at 96 that has 4 years to maturity. Two years later, the customer sells the bond at 99. The tax consequences of this investment are:

- ✗ **A)** 3 points of ordinary income.
- ✗ **B)** 2 points of capital gain and 1 point of ordinary income.
- ✗ **C)** 3 points of capital gain.
- ✓ **D)** 2 points of ordinary income and 1 point of capital gain.

Explanation

When a municipal bond is purchased in the secondary market at a discount, the annual accretion is taxed as ordinary income. The annual accretion is 1 point per year (4 points divided by 4 years to maturity). Therefore, when the bond is sold 2 years later, its cost basis is 98. If the bond is sold at 99, there is a long-term capital gain of 1 point per bond. Also, there is ordinary income taxation on the accretion of 2 points.

Reference: 15.5.7.2 in the License Exam Manual

Question #124 of 214

Question ID: 607229

A customer purchases an XYZ municipal bond at 108. It is scheduled to mature in 16 years. After owning the bond for 10 years, he sells the bond at 102. What capital gain or loss must he report for tax purposes at the time of the sale?

- ✓ **A)** $10 loss.
- ✗ **B)** $20 gain.
- ✗ **C)** $10 gain.
- ✗ **D)** $60 loss.

Explanation

If a municipal bond is purchased at a premium, the premium must be amortized over the time until maturity. An $80 premium on a 16-year municipal bond indicates that $5 will be amortized each year ($80 divided by 16 = $5). After 10 years, the tax basis would be 103 ($1,030). Since the sale was for 102 ($1,020), the customer has a $10 loss on one bond.

Reference: 15.5.7.1 in the License Exam Manual

Question #125 of 214

Question ID: 607260

A customer who owns TCB stock wants to continue holding the security. The stock has fallen from 26 when he bought it on February 2 to a 52-week low of 20.75. He sells the stock on December 1 at the low and repurchases it at 21 on December 15. What is the tax consequence of this investment?

- ✓ **A)** The tax loss is not allowed.
- ✗ **B)** The holding period for the stock was wiped out.
- ✗ **C)** By repurchasing the investment at the same price, he keeps the original cost basis.
- ✗ **D)** He has a capital loss.

Explanation

Since the security was repurchased in less than 30 days, the IRS will not allow the loss due to the wash sale rule. It would have been allowed had the customer bought back the security after 30 days.

Reference: 15.5.6.3 in the License Exam Manual

Question #126 of 214

Question ID: 607265

A mother makes a gift of appreciated securities to her 10-year-old son. The son's cost basis in the stock is the:

- ✗ **A)** market value of the securities on the date of the gift.
- ✗ **B)** market value of the securities on December 31 of the year the gift is made.
- ✗ **C)** market value of the securities on April 15 of the year the gift is made.
- ✓ **D)** original cost of the securities to the mother.

Explanation

When a gift of securities is made while the donor is alive, the original cost of the securities is the cost basis, not the value of the security on the date of the gift. Market value at date of gift is used to determine if gift taxes are applicable.

Reference: 15.5.9.1.2 in the License Exam Manual

Question #127 of 214

Question ID: 607223

If an investor wants to do a tax swap, he could reasonably expect to pay more money if he buys bonds with a:

- ✗ **A)** lower coupon and similar rating.
- ✓ **B)** higher coupon and similar rating.
- ✗ **C)** higher coupon and lower rating.
- ✗ **D)** lower coupon and lower rating.

Explanation

An investor will pay more for a higher coupon with the same rating. A higher coupon translates into a higher price.

Reference: 15.5.6.3 in the License Exam Manual

Question #128 of 214

Question ID: 607147

A registered representative sits down with a new customer to complete the customer account form. During this time the customer expresses being comfortable with some risk to his initial investment in exchange for potentially higher returns. After the registered representative explains that the willingness to accept some risk may allow the account to keep pace with inflation but that it also means the account could lose value, the customer acknowledges that he understands. This customer’s risk tolerance would best be defined as

- ✓ **A)** moderate
- ✗ **B)** moderate aggressive
- ✗ **C)** conservative
- ✗ **D)** aggressive

Explanation

An investment risk tolerance in which the customer is willing to accept some risk to the initial principal sum invested and the potential loss of the funds in exchange for the opportunity to earn higher returns is best defined as moderate.

Reference: 15.2.1.2 in the License Exam Manual

Question #129 of 214

Question ID: 607287

To calculate a capital gain or loss on the sale of an original issue discount municipal bond, the discount must be:

- ✗ **A)** amortized.
- ✗ **B)** depleted.
- ✓ **C)** accreted.
- ✗ **D)** depreciated.

Explanation

The IRS term for adjusting the cost basis of a discount bond upward is "accretion". Amortization is the means of adjusting a premium bond's cost basis.

Reference: 15.5.7.2 in the License Exam Manual

Question #130 of 214

Question ID: 607276

A couple in a high tax bracket is interested in minimizing its tax liability while diversifying its portfolio. Which of the following *best* fits its investment objectives?

- ✓ **A)** Tax-exempt unit trusts.
- ✗ **B)** GNMAs.
- ✗ **C)** Preferred stock.
- ✗ **D)** Corporate convertible bonds.

Explanation

Municipal unit trusts provide tax-free income to unit holders. Unit holders have an undivided interest in the underlying portfolio of municipal bonds. The trust consists of a number of different issues, and therefore has an element of diversification.

Reference: 15.5.4.1.2 in the License Exam Manual

Question #131 of 214

Question ID: 607236

The following dividends were received by a husband, his wife, and both of them jointly: husband-$160; wife-$160; joint-$100. Indicate the amount of dividends that would be subject to taxation if they filed a joint tax return.

- ✓ **A)** $420.
- ✗ **B)** $0.
- ✗ **C)** $220.
- ✗ **D)** $200.

Explanation

$160 + $160 + $100 = $420. This would all be taxable as ordinary income.

Reference: 15.5.4.2 in the License Exam Manual

Question #132 of 214

Question ID: 607193

Market timing is normally associated with which of the following portfolio management styles?

- ✗ **A)** Modern portfolio theory.
- ✗ **B)** Passive management.
- ✗ **C)** Strategic asset allocation.
- ✓ **D)** Tactical asset allocation.

Explanation

Tactical asset allocation, which attempts to capitalize on short-term market swings, is a market timing strategy.

Reference: 15.4.2.2 in the License Exam Manual

Question #133 of 214

Question ID: 607264

Which of the following is federally tax exempt for a corporation?

- ✓ **A)** Municipal bond interest.
- ✗ **B)** Preferred stock dividends.
- ✗ **C)** Foreign corporate stock dividends.
- ✗ **D)** Capital gains.

Explanation

Municipal bonds are tax exempt for corporations as well as for individuals. Preferred stock dividends are taxable but at a reduced rate for corporations due to the 70% dividend exclusion. That break does not apply to the dividends on foreign securities. Regardless of the security, capital gains are taxable.

Reference: 15.5.4.1.2 in the License Exam Manual

Question #134 of 214

Question ID: 721487

Which of the following statements is TRUE?

- ✗ **A)** Both ALPHA and BETA each use different measures of overall performance expectations but cannot be used to measure volatility.
- ✗ **B)** A measure of a stock or portfolio’s volatility is ALPHA and a measure of its performance is BETA.
- ✗ **C)** Both ALPHA and BETA are measures of volatility only and neither measures performance.
- ✓ **D)** A measure of a stock or portfolio’s volatility is BETA and a measure of its performance is ALPHA.

Explanation

A stock’s BETA is a measure of its volatility in relation to the overall market. While ALPHA is a measure of performance that adjusts for risk, relative to a known benchmark.

Reference: 15.3.3.1 in the License Exam Manual

Question #135 of 214

Question ID: 607150

Which of the following provides a measurement of the volatility of a particular stock or portfolio as compared to the volatility of the market as a whole?

- ✗ **A)** Delta.
- ✗ **B)** Alpha.
- ✓ **C)** Beta.
- ✗ **D)** Duration.

Explanation

The beta value is an index that measures the volatility of a stock's or portfolio's movement as compared to the movement of the market as a whole. By definition, the beta of the market is equal to 1.0.

Reference: 15.3.3.1 in the License Exam Manual

Question #136 of 214

Question ID: 607302

A U.S. citizen owns stock in a Canadian company and receives dividends. The Canadian government withholds 15% of the dividends as a tax. As a result, the investor reports a:

- ✗ **A)** reduction in the investor's ordinary income.
- ✗ **B)** non-recoverable loss on the investor's U.S. tax return.
- ✗ **C)** tax credit on the investor's Canadian tax return.
- ✓ **D)** tax credit on the investor's U.S. tax return.

Explanation

An investor receives a credit for taxes withheld on investments by countries with which the United States has diplomatic relations; the tax credit directly decreases the investor's American tax liability.

Reference: 15.5.4.3 in the License Exam Manual

Question #137 of 214

Question ID: 607214

Which of the following statements about municipal original issue premium bonds are TRUE?

I. The original issue premium must be amortized.
II. If the bond is held to maturity, there will be no capital loss reportable.
III. The cost basis of the bond is adjusted downward by the amortized amount.

- ✗ **A)** I and II.
- ✓ **B)** I, II and III.
- ✗ **C)** II only.
- ✗ **D)** I and III.

Explanation

Original issue premium municipal bonds (as well as those purchased in the secondary market) must be amortized by an amount each year so that, if held to maturity, there is no reported capital loss.

Reference: 15.5.7.1 in the License Exam Manual

Question #138 of 214

Question ID: 607212

If a husband makes a gift of $100,000 to his wife, a U.S. citizen, how much of the gift is subject to gift taxes?

- ✗ **A)** 100,000.
- ✗ **B)** $50,000.
- ✓ **C)** $0.
- ✗ **D)** $90,000.

Explanation

Interspousal gifts to citizens of the United States, regardless of amount, are not subject to gift taxes.

Reference: 15.5.9.2.2 in the License Exam Manual

Question #139 of 214

Question ID: 607230

Four years ago, you declared a net capital loss of $23,000 on your tax return. You have had no further capital gains or losses since then. For that year and the following 2, you took the maximum allowable income deduction. How much may you deduct from your income this year, and how much loss will you have to carry forward?

- ✗ **A)** $2,000/$12,000.
- ✗ **B)** $2,000/$11,000.
- ✓ **C)** $3,000/$11,000.
- ✗ **D)** $3,000/$12,000.

Explanation

The maximum allowable deduction against income is $3,000. You will have taken 4 such deductions against $23,000, which leaves you with $11,000 to carry forward ($23,000 - $12,000).

Reference: 15.5.6.1.3 in the License Exam Manual

Question #140 of 214

Question ID: 607273

A customer buys a municipal bond at 106 with 8 years to maturity. What is the amount of unamortized premium at the end of 4 years?

- ✓ **A)** $30.
- ✗ **B)** $36.
- ✗ **C)** $40.
- ✗ **D)** $50.

Explanation

The original premium was $60 for 8 years, which means that after 4 years the remaining premium is half that amount.

Reference: 15.5.7.1 in the License Exam Manual

Question #141 of 214

Question ID: 607242

A customer who sold a bond at a loss must wait how long before he can buy back a substantially identical bond and NOT have the sale classified as a wash sale?

- ✗ **A)** 5 days.

✓ **B)** 30 days.
✗ **C)** There is no waiting period.
✗ **D)** 20 days.

Explanation

According to the wash sale rule, a customer who sells a security at a loss cannot buy back a substantially identical security 30 days prior to or 30 days after the sale that established the loss.

Reference: 15.5.6.3 in the License Exam Manual

Question #142 of 214

Question ID: 721484

A convertible corporate bond with an 8% coupon yielding 7.1% is available, but may be called sometime this year. Which feature of this bond would probably be *least* attractive to your client?

✗ **A)** Current yield.
✓ **B)** Near-term call.
✗ **C)** Coupon yield.
✗ **D)** Convertibility.

Explanation

The near-term call would mean that no matter how attractive the bond's other features, the client may not have very long to enjoy them.

Reference: 15.3.2.6 in the License Exam Manual

Question #143 of 214

Question ID: 607239

An investor has losses on the sale of municipal bonds. Which of the following is TRUE for tax purposes?

✗ **A)** The losses can be applied only against gains on the sale of other debt instruments (bonds).
✗ **B)** The losses can be applied only against gains on the sale of other municipal bonds.
✓ **C)** The losses can be applied against the gains on the sale of any other security.
✗ **D)** No losses on municipal bonds can be applied against gains on sales of any securities.

Explanation

Losses on the sale of one investment can generally be deducted against gains on the sale of any other investment.

Reference: 15.5.6.1.3 in the License Exam Manual

Question #144 of 214

Question ID: 607123

Regarding the topic of outside business activity for associated persons of a FINRA member firm, which of the following statements is NOT TRUE?

✓ **A)** Member firms must grant permission in writing prior to any outside business activity on the part of the associated person.
✗ **B)** A passive investment such as the purchase of a limited partnership unit, is not considered an outside business activity.
✗ **C)** Prior written notice must be provided to the member before any outside business activity may occur.
✗ **D)** An associated person cannot work for any business other than his member firm without his employing broker/dealer’s knowledge.

Explanation

While the member firm has the right to reject or restrict any outside business affiliations if a conflict of interest exists, their prior written approval is not required before the business activity can begin.

Reference: 15.1.2.2 in the License Exam Manual

Question #145 of 214

Question ID: 607180

Rank the following from the safest to the *most* risky.

I. AAA-rated corporate bonds.
II. Blue-chip stocks.
III. U.S. government securities.
IV. Tech stocks.

- ✓ **A)** III, I, II, IV.
- ✗ **B)** III, II, I, IV.
- ✗ **C)** II, III, IV, I.
- ✗ **D)** I, III, IV, II.

Explanation

It should be obvious that U.S. government securities would be first and tech stocks last. As for options II and III, stocks will fluctuate more in price than highly rated corporate bonds.

Reference: 15.3 in the License Exam Manual

Question #146 of 214

Question ID: 607136

Your customer, age 29, makes $42,000 annually and has $10,000 to invest. Although he has never invested before, he wants to invest in something exciting. Which of the following should you suggest?

- ✗ **A)** A growth and income fund because the customer has never invested before.
- ✓ **B)** Your customer should provide more information before you can make a suitable recommendation.
- ✗ **C)** A balanced fund because when the stock market is declining the bond market will perform well.
- ✗ **D)** An aggressive growth fund because the customer is young and has many investing years ahead.

Explanation

It is necessary to get more information about this customer and his definitions of an exciting investment opportunity before making any recommendations. A suitability and risk-tolerance analysis should be performed before a recommendation is made.

Reference: 15.2.1 in the License Exam Manual

Question #147 of 214

Question ID: 721486

Your customer's broad-based portfolio consisting of quality equity securities has returned 4% this year. The S&P 500, a bench mark index, has returned an average 6% over the past several years. Compared to the benchmark index, the customer's portfolio has an ALPHA of

- ✗ **A)** minus 1.5%
- ✗ **B)** 2%
- ✓ **C)** minus 2%
- ✗ **D)** 4%

Explanation

The ALPHA for any investment type, a particular asset or portfolio, is the abnormal rate of return on the investment in relation to what would normally be predicted by a known benchmark. ALPHA can be positive or negative, and in this case, because the portfolio underperformed the benchmark index by 2%, it currently has an ALPHA of minus 2%.

Reference: 15.3.3.1 in the License Exam Manual

Question #148 of 214

Question ID: 607115

A customer's order to buy 500 shares of QRS at 60 is executed when the registered representative reports the trade execution to the customer. One hour later, the customer notices that QRS is down 2 points and he informs the representative that he no longer wants the stock, nor is he planning to pay for it. The representative should tell the customer that:

✗ **A)** the firm will repurchase the securities from the customer for the price paid.

✓ **B)** the customer owns the stock and must submit payment.

✗ **C)** the customer may sell the stock at the purchase price in the open market.

✗ **D)** the representative will personally repurchase the securities from the customer for the price paid.

Explanation

The customer has entered into a contract to purchase a security as soon as the buy order is executed, and must pay regardless of any subsequent change in the market price. The firm and the representative are prohibited from offering to repurchase the securities at the original price.

Reference: 15.1.3.7 in the License Exam Manual

Question #149 of 214

Question ID: 607141

When making recommendations to an advisory client, which of the following carry the *most* weight?

I. The client's risk tolerance.
II. Past performance of the adviser representative's recommendations.
III. The client's investment needs and objectives.
IV. The client's previous investment experience with other advisers.

✗ **A)** II and III.

✓ **B)** I and III.

✗ **C)** II and IV.

✗ **D)** I and IV.

Explanation

Investment objectives and risk tolerance should determine recommendations to an individual advisory client.

Reference: 15.2.1.2 in the License Exam Manual

Question #150 of 214

Question ID: 607249

XYZ Corp. owns 18% of the voting common stock of ABCD Enterprises. In the current tax year, XYZ receives $250,000 in dividend income from its investment in ABCD. If XYZ has a marginal tax rate of 34%, what is its tax liability on the dividend income received?

✗ **A)** $85,000.

✓ **B)** $25,500.

✗ **C)** $0.

✗ **D)** $42,500.

Explanation

Under the inter-corporate dividend exclusion rule, if a corporation owns stock in another corporation, 70% of the dividends received is excluded from taxation. Therefore, only 30% of the $250,000 received is subject to tax (30% × $250,000 = $75,000). Applying a tax rate of 34% to $75,000 results in a tax liability of $25,500.

Reference: 15.5.11.1 in the License Exam Manual

Question #151 of 214

Question ID: 607278

A corporation in the 35% tax bracket reports operating income of $4 million for the year. The firm also received $200,000 in preferred dividends. Assuming no other items of income or expense, what is the company's tax liability?

✗ **A)** $1,756,000.

✗ **B)** $1,370,200.

✗ **C)** $1,360,000.

✓ **D)** $1,421,000.

Explanation

The corporation's $4 million operating income is taxed at a rate of 35%. For tax purposes, corporations can exclude 70% of all dividends received from domestic common and preferred stocks. Thus, 30% of the $200,000 received from preferred dividends is taxed at the 35% tax rate ($200,000 times 30% equals $60,000). The $4 million in income plus the $60,000 in taxable dividends equals $4,060,000 ($4,060,000 multiplied by a 35% tax rate equals taxes of $1,421,000).

Reference: 15.5.11.1 in the License Exam Manual

Question #152 of 214

Question ID: 607207

Interest income from all of the following are exempt from state and local taxation EXCEPT:

- ✗ **A)** Treasury bills.
- ✗ **B)** Series EE savings bonds.
- ✗ **C)** Treasury bonds.
- ✓ **D)** FNMA mortgage-backed issues.

Explanation

As a general rule, the interest income from U.S. government and agency securities is subject to federal taxation only; it is generally exempt from state and local taxation. However, the interest income from mortgage-backed securities is fully taxable.

Reference: 15.5.4.1.1 in the License Exam Manual

Question #153 of 214

Question ID: 607283

If your client has a $21,000 net capital loss this year and he plans to apply the maximum deduction toward his ordinary income for the year, after this year he may:

- ✗ **A)** not carry the loss forward.
- ✗ **B)** carry the loss forward indefinitely and offset capital gains only.
- ✗ **C)** carry $3,000 of the loss forward.
- ✓ **D)** deduct a maximum of $3,000 per year and carry the remaining loss forward indefinitely.

Explanation

Capital losses may be used to offset capital gains. Once all capital gains have been offset, $3,000 of net capital losses may be used to offset ordinary income annually. Remaining losses may be carried forward in future years until the loss is exhausted.

Reference: 15.5.6.1.3 in the License Exam Manual

Question #154 of 214

Question ID: 721490

One of your customers has donated securities that have appreciated over time since they were first purchased to her favorite charity. Wanting to use the donation as a tax deduction on her tax return the customer would be advised that she will be allowed to deduct

- ✗ **A)** the original cost of the securities when initially purchased
- ✗ **B)** the amount by which the securities have gone up in value above the purchase price
- ✓ **C)** the market value of the securities on the date the donation was made
- ✗ **D)** no portion of the donation

Explanation

When an individual has donated appreciated securities to a charity, the amount of the allowable tax deduction is equal to the current market value of the securities on the day the donation was made.

Reference: 15.5.9.1.1 in the License Exam Manual

Question #155 of 214

Question ID: 607280

Three years ago, a customer purchased 300 shares of ACE Fund. He sold the shares on August 15 for a loss of $400. He then purchased 300 shares of the same fund on September 4 of the same year. If the investor is in a 10% tax bracket how will the loss be treated for tax purposes in the current year?

- ✗ **A)** The loss is fully deductible.
- ✓ **B)** The loss is not deductible.
- ✗ **C)** 10% of the loss is deductible.
- ✗ **D)** The loss is only deductible to the extent that gains of an equal or greater amount were incurred.

Explanation

Because the customer repurchased the shares within 30 days of the loss transaction the loss is disallowed under the wash sale rule and therefore not deductible. A wash sale occurs when the same shares are purchased within 30 days before or after the date of sale that the loss is incurred.

Reference: 15.5.6.3 in the License Exam Manual

Question #156 of 214

Question ID: 607174

A portfolio manager using index options is trying to reduce which of the following types of risks?

- ✗ **A)** Selection.
- ✗ **B)** Financial.
- ✗ **C)** Purchasing power.
- ✓ **D)** Systematic.

Explanation

Systematic risk (sometimes called systemic risk) refers to the impact the overall market has on an equity portfolio's value. Index options help insure portfolios against systematic risk. The purchase of index puts to protect a portfolio is termed portfolio insurance.

Reference: 15.3.2.7 in the License Exam Manual

Question #157 of 214

Question ID: 607217

If a customer buys a municipal bond at 110, maturing in 8 years, but sells the bond 6 years later at 103½, the customer will have a:

- ✗ **A)** $35 per bond gain.
- ✗ **B)** $65 per bond loss.
- ✓ **C)** $10 per bond gain.
- ✗ **D)** $10 per bond loss.

Explanation

Municipal bonds that are purchased at a premium must be amortized. This bond has a premium of $100, which over 8 years amounts to $12.50 per year. The cost basis of the bond at the time of the sale is $1,100 − (6 × $12.50) or $1,025. If the bond is sold for $1,035, the customer has a gain of $10 per bond.

Reference: 15.5.7.1 in the License Exam Manual

Question #158 of 214

Question ID: 607204

If a municipal bond with 10 years to maturity is purchased from the issuer for 110, and after 2 years it is sold for 110, the bondholder must report:

- ✓ **A)** capital gain of 2 points.
- ✗ **B)** capital loss of 2 points.
- ✗ **C)** capital gain of 20 points.
- ✗ **D)** no capital gain or loss.

Explanation

Municipal bonds bought at a premium must be amortized. The amount of the premium is 10 points. With 10 years to maturity, the annual amortization is 1 point. After 2 years, the bond's cost basis has been amortized down to 108. If at that point, it is sold for 110, there is a 2-point capital gain.

Reference: 15.5.8 in the License Exam Manual

Question #159 of 214

Question ID: 607124

A registered representative (RR) at a FINRA member broker/dealer has a brother who is a Certified Public Accountant (CPA), operating his own accounting firm. The 2 brothers decide that they will pay one another for business referrals in the form of a flat fee each time one of them refers a client to the other. For the FINRA member RR, this arrangement is

- ✗ **A)** allowed because the fee is a flat one and, therefore, not connected to the amount of business the referred customer might do
- ✗ **B)** allowed so long as the fee is agreed upon in writing before either of them refers a client to the other
- ✗ **C)** prohibited because finder's fees are disallowed amongst financial firms under the anti-money laundering provisions of the Bank Secrecy Act
- ✓ **D)** prohibited because FINRA rules do not allow cash or non-cash payment for customer referrals to anyone who is not a FINRA member

Explanation

FINRA rules do not allow cash or non-cash payment for customer referrals to anyone who is not a FINRA member. The prohibition regarding referrals or finder's fees includes payments made in connection with locating, introducing, or referring brokerage account customers to the member firm or registered representative.

Reference: 15.1.2.5 in the License Exam Manual

Question #160 of 214

Question ID: 607129

An associated person of a broker dealer who wishes to accept an outside employment opportunity must notify the

- ✓ **A)** member firm in writing
- ✗ **B)** SEC in writing
- ✗ **C)** FINRA in writing
- ✗ **D)** customers of the broker dealers in writing

Explanation

Notification must be made to the member firm in writing.

Reference: 15.1.2.2 in the License Exam Manual

Question #161 of 214

Question ID: 607295

A customer has realized a capital gain from the sale of a municipal bond. To reduce his tax liability, the capital gain can be offset against a capital loss in which of the following investments?

I. GOs
II. Equity securities.
III. Corporate bonds.
IV. Collateralized mortgage obligation.

- ✗ **A)** I and II.
- ✗ **B)** II and III.
- ✓ **C)** I, II, III and IV.
- ✗ **D)** I and III.

Explanation

Any capital loss will offset a capital gain.

Reference: 15.5.6.1.3 in the License Exam Manual

Question #162 of 214

Question ID: 607290

Which of the following statement(s) regarding gift taxes are TRUE?

I. Gifts per person per year up to an IRS specified dollar limit can be given without a tax liability.
II. Gifts per person per year in excess of the IRS specified dollar limit for that year may be subject to tax.
III. The donor, not the recipient, is responsible for any tax liability.
IV. The tax rate increases with the size of the gift.

- ✗ **A)** I and II.
- ✗ **B)** III and IV.
- ✗ **C)** II and III.
- ✓ **D)** I, II, III and IV.

Explanation

In accordance with gift tax regulations as mandated by the IRS, an individual may give a gift of up to a specified dollar limit per person in one year with no gift tax liability. If the gift exceeds the IRS specified dollar limit it is the donor who is responsible for any tax. The gift tax is a progressive tax, which means that as the size of the gift increases, the percentage of applicable tax will also increase. The IRS specified gift tax limit is subject to change from year to year.

Reference: 15.5.9.2.2 in the License Exam Manual

Question #163 of 214

Question ID: 607286

If a customer purchases 5 newly issued municipal bonds for 101 and holds the bonds to maturity, the tax consequence is:

- ✗ **A)** $50 capital loss.
- ✗ **B)** $50 capital gain.
- ✗ **C)** not possible to calculate with the information provided.
- ✓ **D)** $0 gain or loss.

Explanation

If a new issue municipal bond is bought at a premium, the premium must be amortized over the life of the bond. At maturity, no capital gain or loss would occur because the premium would have been fully amortized.

Reference: 15.5.7.1 in the License Exam Manual

Question #164 of 214

Question ID: 607154

Which of the following securities carries the highest degree of purchasing power risk?

- ✗ **A)** Convertible cumulative preferred stock.
- ✓ **B)** Long-term, high-grade bond.
- ✗ **C)** Short-term note.
- ✗ **D)** Blue-chip stock.

Explanation

The longer a fixed-income investment is held, the more vulnerable the investor is to purchasing power risk from inflation. Although preferred stock is also a fixed-income investment, convertible preferred will increase in value with the underlying common stock.

Reference: 15.3.2.1 in the License Exam Manual

Question #165 of 214

Question ID: 607305

If a book author receives royalty payments from a publisher, the payments will be taxable as which of the following types of income?

- ✗ **A)** The payments are not taxable.
- ✗ **B)** Passive income.

✗ **C)** Portfolio income.
✓ **D)** Earned income.

Explanation

The author received royalties as a result of an active trade or business, therefore the payments are considered earned income.

Reference: 15.5.3.1 in the License Exam Manual

Question #166 of 214

Question ID: 607220

If a customer wants a year-end tax swap, he can expect to pay more money for the swap if the bonds purchased have a:

I. lower coupon.
II. higher coupon.
III. lower rating.
IV. higher rating.

✓ **A)** II and IV.
✗ **B)** I and IV.
✗ **C)** II and III.
✗ **D)** I and III.

Explanation

Higher coupon rates and higher ratings make bonds more valuable.

Reference: 15.5.6.3 in the License Exam Manual

Question #167 of 214

Question ID: 607201

The capital asset pricing model assumes

✓ **A)** investors are averse to risk and expect to be rewarded for taking risk
✗ **B)** that no type of risk can be diversified away
✗ **C)** that those who participate in smaller transactions are generally wrong in regards to timing purchases and sales
✗ **D)** that prices are influenced by supply and demand only

Explanation

CAPM takes into account systematic risk, the type of risk that investors use diversification to lessen. It assumes that investors are averse to risk, and, if taking on risk, expect to be rewarded for it and, therefore, the pricing of an asset must reflect that.

Reference: 15.4.1 in the License Exam Manual

Question #168 of 214

Question ID: 607153

Credit risk involves:

✓ **A)** possibility of issuer default.
✗ **B)** danger of not being able to sell the investment at a fair market price.
✗ **C)** inflationary risks.
✗ **D)** fluctuations in overall interest rates.

Explanation

Credit risk is the danger of losing all or part of the invested principal as the result of the issuer's failure.

Reference: 15.3.2.8 in the License Exam Manual

Question #169 of 214

Question ID: 607155

Traders in stock index options are exposed to:

- ✗ **A)** call risk.
- ✓ **B)** systematic risk.
- ✗ **C)** redemption risk.
- ✗ **D)** credit risk.

Explanation

Systematic risk is the possibility that an overall decline in the market will cause a loss in an investment. Index options investors are exposed to the risk that market movement will cause the option positions to move adversely.

Reference: 15.3.2.7 in the License Exam Manual

Question #170 of 214

Question ID: 607142

A customer would diversify his portfolio geographically to avoid which of the following risks?

I. Adverse economic conditions in a particular region.
II. Legislative changes by a state.
III. Decreasing bond prices.
IV. Decreasing stock prices.

- ✗ **A)** II and III.
- ✓ **B)** I and II.
- ✗ **C)** I and IV.
- ✗ **D)** III and IV.

Explanation

Geographic diversification can be used to avoid such risks as economic declines in various regions and changes in legislation at the state level.

Reference: 15.2.2.5 in the License Exam Manual

Question #171 of 214

Question ID: 607237

Progressive taxes would include:

I. personal income tax.
II. gift taxes.
III. estate taxes.
IV. excise taxes.

- ✗ **A)** II, III and IV.
- ✗ **B)** I and III.
- ✓ **C)** I, II and III.
- ✗ **D)** I and II.

Explanation

Progressive taxes are those taxes where the rate of taxation increases as the dollars being taxed increase. Personal income tax, while not as progressive as it was prior to the 1986 reform, is still considered a progressive tax since the highest tax rate is levied against the highest earnings. Gift taxes and estate taxes are highly progressive, but excise taxes, such as fuel tax and transportation tax, are a fixed rate and therefore would not be considered progressive.

Reference: 15.5.2 in the License Exam Manual

Question #172 of 214

Question ID: 607202

While reviewing a new customer's investment profile, you determine that the customer is willing to tolerate a high degree of risk and does not anticipate utilizing the invested funds for at least 15 years. What would be a suitable recommendation regarding asset allocation for the customer's portfolio given the customer's risk tolerance and time horizon criteria?

- ✗ **A)** 25% debt, 25% equities, 25% money market instruments, and 25% real estate
- ✓ **B)** 70% equities, 20% debt, and 10% money-market instruments
- ✗ **C)** 65% debt and 35% equities
- ✗ **D)** 45% debt, 45% equities, and 10% money-market instruments

Explanation

For an investor who has a long-term investment time horizon and is willing to tolerate higher levels of risk, a recommendation having a higher percentage of the portfolio in equities would be suitable. Of the asset mixes presented only one has a majority percentage in equities. The remaining choices with higher percentages in debt securities are too conservative.

Reference: 15.4.2 in the License Exam Manual

Question #173 of 214

Question ID: 607279

A customer buys $10,000 worth of new issue municipal bonds at a price of 104 and the bonds have 10 years to maturity. Four years after purchasing the bonds, she sells them at 99. What is the tax loss on these bonds?

- ✗ **A)** 400.
- ✓ **B)** 340.
- ✗ **C)** 500.
- ✗ **D)** 160.

Explanation

To arrive at adjusted cost basis the premium on a new issue municipal bond must be amortized (subtract). To amortize the premium annually, divide the premium amount (in this case, $400 on the total purchase of 10 bonds) by the number of years until maturity (10). Thus, the customer writes down the initial cost by $40 per year. After 4 years, the bonds purchased at a cost of $10,400 will be written down to $10,240 (4 years $40 per year = $160). If the bonds are sold for $9,900, the tax loss is $340 ($10,240 − $9,900 = $340).

Reference: 15.5.7.1 in the License Exam Manual

Question #174 of 214

Question ID: 607166

If a customer attempts to place an order for municipal securities that the registered representative deems completely unsuitable for the customer, the registered representative:

- ✓ **A)** may execute the order and mark the order ticket as "unsolicited".
- ✗ **B)** must refuse to execute the order.
- ✗ **C)** must obtain the permission of a municipal securities principal before executing the order.
- ✗ **D)** may execute the order on a not-held basis.

Explanation

A registered representative may enter any unsolicited order from a customer despite the fact that the representative believes the trade to be unsuitable for the customer. The representative must mark the order ticket "unsolicited".

Reference: 15.3.1 in the License Exam Manual

Question #175 of 214

Question ID: 721482

In constructing a profile for your customer, you wish to assemble information on both financial and nonfinancial investment considerations that affect your customer. Which of the following qualify as financial investment considerations?

I. Your customer's tolerance of various forms of risk.
II. Your customer's dependents and their ages.
III. Your customer's liquid net worth.
IV. Your customer's monthly credit card payments.

- ✗ **A)** II and IV.

- ✗ **B)** I and II.
- ✗ **C)** I and III.
- ✓ **D)** III and IV.

Explanation

Liquid net worth and expenses such as credit card payments involve concrete sums of money and cash flow and thus, are financial. Number of dependents and risk tolerance should be considered regarding suitability and making appropriate recommendations but they are nonfinancial considerations.

Reference: 15.2.1 in the License Exam Manual

Question #176 of 214

Question ID: 607213

All of the following statements about the taxation of municipal and corporate bonds are true EXCEPT:

- ✗ **A)** municipal bondholders must accrete original issue discount bonds annually.
- ✗ **B)** corporate bondholders must accrete original issue discount bonds annually.
- ✗ **C)** municipal bondholders must amortize premium bonds annually.
- ✓ **D)** corporate bondholders must amortize premium bonds annually.

Explanation

If an investor purchases a corporate bond at a premium, the investor has the option of whether or not to amortize the premium. Amortization reduces both reported interest income and cost basis.

Reference: 15.5.8 in the License Exam Manual

Question #177 of 214

Question ID: 607313

Investors who are subject to the alternative minimum tax (AMT) will lose the tax benefits normally associated with

- ✗ **A)** gains associated with variable annuity portfolios
- ✗ **B)** capital losses
- ✓ **C)** tax preference items
- ✗ **D)** losses on options positions

Explanation

Certain items receive favorable tax treatment from the IRS. One example is tax-exempt interest on private-purpose municipal revenue bonds. These types of items are known as tax preference items. For investors who are subject to the alternative minimum tax (AMT), the benefits normally associated with tax preference items are lost, because these items must be added back into the investor's taxable income.

Reference: 15.5.10.1 in the License Exam Manual

Question #178 of 214

Question ID: 607177

Which of the following statements regarding nonsystematic risk are TRUE?

I. It is the risk that an individual stock will not perform well.
II. It is the same as market risk.
III. Diversification reduces it.
IV. Diversification does not reduce it.

- ✓ **A)** I and III.
- ✗ **B)** II and III.
- ✗ **C)** II and IV.
- ✗ **D)** I and IV.

Explanation

Nonsystematic risk is company risk, the risk that an individual investment will perform poorly. Diversification can reduce most nonsystematic risks.

Reference: 15.3.2.7 in the License Exam Manual

Question #179 of 214

Question ID: 607233

Your client owns stock in the TXR Corporation and has received dividends of $950 this year. The client has taken $450 of this and used it to purchase additional shares of TXR. For tax purposes, your client must report:

- ✗ **A)** $450.
- ✗ **B)** $1,400.
- ✗ **C)** $500.
- ✓ **D)** $950.

Explanation

All of the dividends received must be reported. Reinvesting any or all of the money in TXR stock does not reduce the client's tax liability on dividends received.

Reference: 15.5.4.2 in the License Exam Manual

Question #180 of 214

Question ID: 607263

If a high-income customer is subject to AMT, which of the following preference items must be added to adjusted gross income to calculate his tax liability?

- ✗ **A)** Interest on a municipal bond issued to finance highway construction.
- ✓ **B)** Interest on a private purpose municipal bond.
- ✗ **C)** Distributions from a corporate bond mutual fund.
- ✗ **D)** Income from a municipal security issued to finance parking garages.

Explanation

If more than 10% of a bond's proceeds go to private entities, the interest on the bond is a tax preference item for alternative minimum tax purposes.

Reference: 15.5.10 in the License Exam Manual

Question #181 of 214

Question ID: 607167

John purchased stock of a company in the business of manufacturing yachts. Two years ago his securities had lost *most* of their value as a result of a congressionally imposed luxury tax on purchases of more than $30,000. John's investment in the yacht-building business suffered a loss due to:

- ✗ **A)** volatility.
- ✗ **B)** interest rate risk.
- ✗ **C)** business risk.
- ✓ **D)** regulatory (legislative) risk.

Explanation

John's investment in the yacht-building business suffered a loss as a result of regulatory (legislative) risk. In other words, the rules of the game (i.e., tax treatment) changed after John purchased the security.

Reference: 15.3.2.10 in the License Exam Manual

Question #182 of 214

Question ID: 607246

If an investor swaps identical issues of stock to establish a loss that is disallowed, the transaction is known as:

- ✗ **A)** a reverse stock split.
- ✗ **B)** a stock cross.
- ✓ **C)** a wash sale.

✗ **D)** a stock swap.

Explanation

The wash sale rule disallows claiming a tax loss on the sale of stock if the investor purchases a substantially identical security within 30 days either before or after the date of such sale.

Reference: 15.5.6.3 in the License Exam Manual

Question #183 of 214

Question ID: 681950

A customer purchases a 6% municipal bond in the secondary market on a 7% basis. The effective after-tax yield is

✗ **A)** 0.06
✓ **B)** 6 to 7%
✗ **C)** 0.07
✗ **D)** greater than 7%

Explanation

In every case but one, the yield to maturity is the effective after-tax yield to a municipal-bond buyer. The one exception is a bond bought at a discount in the secondary market. In this case, the annual accretion is taxed as ordinary income. The discount, which is included in the stated yield to maturity, is taxable, reducing the effective after-tax yield to somewhere between the coupon of 6% and the yield to maturity of 7%.

Reference: 15.5.7.2 in the License Exam Manual

Question #184 of 214

Question ID: 607190

Which of the following *best* describes a growth investment?

✗ **A)** Only interest and dividends are reinvested.
✓ **B)** Value of the investment increases over time.
✗ **C)** Both principal and accumulating interest and dividends increase over time.
✗ **D)** Investment appreciation is tax-deferred.

Explanation

Growth refers to an increase in an investment's value over time. Interest and dividends are income.

Reference: 15.4.3.1 in the License Exam Manual

Question #185 of 214

Question ID: 607149

Duration would be the greatest for which of the following bonds?

✗ **A)** 6% coupon, maturing in 5 years.
✗ **B)** 6% coupon, maturing in 10 years.
✓ **C)** 5.5% coupon, maturing in 10 years.
✗ **D)** 5.5% coupon, maturing in 5 years.

Explanation

Duration measures the time in years it takes for a bond to pay for itself. Duration is greatest for bonds with lower coupons and bonds with longer maturities.

Reference: 15.3.3.2 in the License Exam Manual

Question #186 of 214

Question ID: 721485

Which of the following best describes ALPHA for an investor’s portfolio?

- ✗ **A)** It is a measure of each portfolio assets risk to arrive at the risk associated with the entire portfolio.
- ✗ **B)** It is the prediction of performance aligning with the risk of a known benchmark.
- ✗ **C)** It is a measure of risk that adjusts in accordance with the performance of a known benchmark.
- ✓ **D)** It is a measure of performance that adjusts for risk, relative to a known benchmark.

Explanation

ALPHA is a measure of performance that adjusts for risk, relative to a known benchmark. The ALPHA for any investment type, a particular asset, or portfolio is the abnormal rate of return on the investment in relation to what would normally be predicted by the benchmark.

Reference: 15.3.3.1 in the License Exam Manual

Question #187 of 214

Question ID: 607125

Your broker/dealer provides occasional research reports to an institutional trading desk in exchange for that institution doing executions for its various fund portfolios through your broker. This is known as

- ✗ **A)** churning
- ✗ **B)** front running
- ✓ **C)** soft dollar arrangement
- ✗ **D)** customer portfolio margining (CPM)

Explanation

Soft dollar arrangements are ones in which a broker/dealer may provide products or services to an advisor or fiduciary in general, in exchange for that advisor directing brokerage transactions to the broker/dealer for execution.

Reference: 15.1.3.6.1 in the License Exam Manual

Question #188 of 214

Question ID: 607294

An investor has the following tax picture in 2006:

Tax loss carryover from 2005: $9,000
Capital gains: $15,000
Capital losses: $2,000

What is the investor's gain or loss?

- ✓ **A)** $4,000 net capital gains.
- ✗ **B)** $13,000 net capital gains.
- ✗ **C)** $6,000 net capital gains.
- ✗ **D)** $13,000 net capital gains and a $4,000 loss carryover into 2006.

Explanation

In determining an investor's capital gain or loss for the tax year, all gains and losses must be aggregated and offset against each other. In this situation, the prior year's loss carryover of $9,000 is added to the current year's loss of $2,000. The total loss of $11,000 is offset against the total capital gains of $15,000 for a net capital gain of $4,000.

Reference: 15.5.6.1.3 in the License Exam Manual

Question #189 of 214

Question ID: 607205

Which of the following are taxable to an investor?
I. Stock dividends.
II. Cash dividends.
III. Stock splits.
IV. Interest income on foreign bonds.

- ✗ **A)** I and III.
- ✗ **B)** II and III.
- ✗ **C)** I and IV.
- ✓ **D)** II and IV.

Explanation

Stock dividends and stock splits are not taxable to investors. As the result of either, the customer has 2 nickels instead of a dime. The effect of a split on stock dividends is to reduce the investor's cost basis. Cash dividends, however, are taxable, as is the interest income from foreign bonds.

Reference: 15.5.6.1 in the License Exam Manual

Question #190 of 214

Question ID: 721489

An investor has purchased a number of securities including municipal bonds on margin. The margin interest paid to borrow the funds to purchase the municipal bonds is

- ✗ **A)** partially deductible
- ✗ **B)** fully deductible
- ✓ **C)** not deductible
- ✗ **D)** only deductible if the investor has investment income

Explanation

Interest received from municipal bonds is tax exempt and therefore the government does not allow margin interest paid to purchase them to be used as a deduction on one's income tax return.

Reference: 15.5.9.3 in the License Exam Manual

Question #191 of 214

Question ID: 607126

Under the 1934 Securities Exchange Act, all of the following are likely to qualify under the SEC's safe harbor rule regarding soft dollar arrangements EXCEPT

- ✓ **A)** a broker/dealer providing office furniture and computers in exchange for commissionable trades being directed to the broker/dealer
- ✗ **B)** a broker/dealer providing research reports to the advisor in exchange for directing transactions to the broker/dealer
- ✗ **C)** a broker/dealer providing seminars to assist in the analysis of securities in exchange for directing transactions to the broker/dealer
- ✗ **D)** a broker/dealer providing software to assist in the analysis of securities in exchange for directing transactions to the broker/dealer

Explanation

A broker/dealer providing office furniture, telephone lines, or computer equipment to any advisor or financial institution in exchange for directed commissionable transactions to the broker/dealer would generally not fall under the SEC's safe harbor rule regarding soft dollar arrangements.

Reference: 15.1.3.6.1.1 in the License Exam Manual

Question #192 of 214

Question ID: 607169

Which type of risk is a mortgage-backed security *most* likely to experience?

- ✗ **A)** Business or corporate risk.
- ✓ **B)** Reinvestment rate risk.
- ✗ **C)** Market risk.
- ✗ **D)** Exchange rate risk.

Explanation

A mortgage-backed security, such as a collateralized mortgage obligation (CMO), is most likely to experience reinvestment rate risk. As mortgages are paid off early and refinanced in the event of declining interest rates, the interim cash flows received from the obligation must be reinvested in lower yielding securities. This is the practical effect of prepayment risk.

Reference: 15.3.2.5 in the License Exam Manual

Question #193 of 214

Question ID: 607140

A 27-year-old client is in the lowest tax bracket and seeks an aggressive long-term growth investment. If his investment adviser representative recommends a high-rated general obligation municipal bond, the IAR has:

- ✓ **A)** made an unsuitable recommendation based on the client's needs and objectives.
- ✗ **B)** recommended a suitable investment because GOs are good long-term investments.
- ✗ **C)** made an unsuitable recommendation, since a municipal revenue bond would have been more appropriate.
- ✗ **D)** committed no violation because municipal bonds are well suited for the market's volatility.

Explanation

In recommending a conservative, tax-exempt investment to this customer, the investment adviser representative has failed to make a suitable recommendation given the client's objectives. Municipal bonds are better suited for individuals in high tax brackets and offer little upside appreciation potential.

Reference: 15.2.1 in the License Exam Manual

Question #194 of 214

Question ID: 607258

A successful chain of retail stores in the maximum corporate tax bracket may exclude from taxation 70% of income earned on investments in:

- ✗ **A)** government and agency securities.
- ✗ **B)** industrial development bonds.
- ✓ **C)** corporate common and preferred stock.
- ✗ **D)** municipal bonds from the same state in which the corporation is located.

Explanation

Corporate ownership of another company's stock allows the investor to exclude 70% of the dividends from taxation.

Reference: 15.5.11.1 in the License Exam Manual

Question #195 of 214

Question ID: 607292

An investor purchases 1,000 shares of ABC at $42 per share. One year later, the stock is trading at $50 per share and the investor receives 50 shares of ABC as a stock dividend. How will this dividend be currently taxed?

- ✓ **A)** The shares are not subject to taxation.
- ✗ **B)** As a $2,500 capital gain.
- ✗ **C)** As $2,500 ordinary income.
- ✗ **D)** As a $2,100 capital gain.

Explanation

Shares received per a stock dividend are not currently taxable. Instead, shareholders who receive stock dividends must adjust their cost basis in the shares downward. The total number of new shares, multiplied by their new adjusted basis, must equal the shareholder's total interest before the stock dividend was received.

Reference: 15.5.6.1 in the License Exam Manual

Question #196 of 214

Question ID: 694429

An investor purchases a municipal bond at par for $10,000 on February 15, 1997. On August 15, 1997, if the investor sells the bond for $10,500, for tax purposes the $500 profit is recognized as

✓ **A)** a short-term capital gain
✗ **B)** a long-term capital gain
✗ **C)** interest income
✗ **D)** a tax-free capital gain

Explanation

When municipal bonds are purchased at par and subsequently sold at a higher price, the resulting profit is taxed as a capital gain. Only interest income from municipal bonds is exempt from taxation. This gain is not classified as long-term because the investor did not hold the bond for more than 1 year.

Reference: 15.5.6 in the License Exam Manual

Question #197 of 214

Question ID: 607128

The practice of placing clients who trade infrequently in fee-based accounts has been identified by the SEC as

✗ **A)** front running
✓ **B)** reverse churning
✗ **C)** interpositioning
✗ **D)** pegging

Explanation

The SEC has identified reverse churning as the specific practice of placing clients who trade infrequently in fee-based accounts where one annual fee is paid rather than paying commissions per trade. If the annual fee paid would be appreciably greater than the annual commissions paid given the number of transactions the customer would normally do or could be reasonably expected to do, the fee-based account would not be appropriate and this would be considered reverse churning.

Reference: 15.1.3.1.1 in the License Exam Manual

Question #198 of 214

Question ID: 607168

Which of the following types of risk CANNOT be eliminated through diversification under the modern portfolio theory?

✓ **A)** Systemic risk.
✗ **B)** Liquidity risk.
✗ **C)** Business risk.
✗ **D)** Interest rate risk.

Explanation

Market risk, sometimes referred to as systemic or systematic risk, cannot be diversified away. The risk of investing in a single industry or sector can be diversified away by investing in several industries with returns not correlated to each other. A general downturn in the market, however, cannot be eliminated through diversification.

Reference: 15.3.2.7 in the License Exam Manual

Question #199 of 214

Question ID: 607187

A formula timing plan that consists of periodic purchases of a fixed dollar amount of stock regardless of price is known as:

✗ **A)** share averaging.
✗ **B)** constant dollar plan.
✗ **C)** constant ratio plan.
✓ **D)** dollar cost averaging.

Explanation

There is no such thing as share averaging. Constant dollar and constant ratio plans do not involve periodic purchase of securities. They involve buying and selling equity and debt securities to keep either a constant dollar or constant ratio between the two. Dollar cost averaging calls for the investor to make regular purchases over a long period.

Reference: 15.4.1.2 in the License Exam Manual

Question #200 of 214

Question ID: 607308

Your customer owns shares of LMN stock that have gone up in value. He does not wish to sell the shares now because he does not want to realize the capital gain. To lock in the gain without selling those shares, he sells shares of LMN stock short, holding both the long and short positions simultaneously. You recognize this tax strategy as

- ✓ **A)** selling or shorting against the box
- ✗ **B)** a wash sale
- ✗ **C)** commingling
- ✗ **D)** advance or pre-refunding

Explanation

Selling or shorting against the box is a tax strategy used to defer capital gains into the next tax year. Selling shares short of a company when you are already long effectively locks in any gain you have on the long position. For every dollar gained in the long position, you lose one in the short position, and vice versa. Ultimately, in the next tax year, the long shares are used to replace the borrowed shares for the short position, which effectively closes both positions, and any gain would then be taxable. The IRS mandates that certain other criteria be met to utilize this tax strategy.

Reference: 15.5.9.4 in the License Exam Manual

Question #201 of 214

Question ID: 607172

Most rating services rate which of the following?

- ✓ **A)** Quality.
- ✗ **B)** Marketability.
- ✗ **C)** Durability.
- ✗ **D)** Reinvestment risk.

Explanation

The rating services are concerned with quality, which is defined as the ability of the issuer or guarantor to pay (default risk).

Reference: 15.3.2.8 in the License Exam Manual

Question #202 of 214

Question ID: 607164

All of the following are true concerning a market's beta EXCEPT:

- ✓ **A)** it provides a measurement of a range that the market may move in any given day.
- ✗ **B)** it shows that if a stock's beta is 1.2 and the market moves by 5%, the stock would move by 6%.
- ✗ **C)** it is by definition equal to 1.
- ✗ **D)** it serves as a benchmark for measuring the relative volatility of a stock or portfolio against the movement of the market itself.

Explanation

The beta is a benchmark and does not indicate anything about market movement as a whole. It only measures the movement of a particular security or portfolio as compared to the movement of the entire market.

Reference: 15.3.3.1 in the License Exam Manual

Question #203 of 214

Question ID: 607109

A member firm wants to give a gift to a registered representative of another member firm. Which of the following would be applicable to the gift?

- ✗ **A)** This is permitted only if the gift does not exceed $100 and the recipient registered representative's employer consents.
- ✓ **B)** This is permitted only if the gift does not exceed $100.
- ✗ **C)** This is permitted only if the gift does not exceed $100 and FINRA's approval is obtained.

- ✗ **D)** This is permitted only if the gift does not exceed $150.

Explanation

The Conduct Rules place restrictions on the gift-giving activities of registered personnel. Specifically, an employee of one member firm may give gifts up to $100 every 12 months to a registered representative of another member firm. This is designed to prevent employees of different broker/dealers from working together in a way that would be detrimental to the investing public. Notification to or approval by FINRA or the receiving registered representative's firm is not required.

Reference: 15.1.3.2 in the License Exam Manual

Question #204 of 214

Question ID: 607133

If a client is moderately risk-averse and has an investment objective of capital preservation, what types and allocation of investments would you recommend for this customer?

- ✓ **A)** A mix of investment-grade bonds and cash/cash equivalents.
- ✗ **B)** A preponderance of growth stocks and limited partnership vehicles.
- ✗ **C)** A preponderance of speculative stocks and high-yield bonds.
- ✗ **D)** A mix of high yield bonds and cash/cash equivalents.

Explanation

An individual with an investment objective of capital preservation should be investing in a mix of investment grade bonds and cash/cash equivalents. Lower risk capital appreciation vehicles, such as large-cap common stock, should also be considered. The other choices noted are too risky for a risk-averse investor.

Reference: 15.2.2.1 in the License Exam Manual

Question #205 of 214

Question ID: 607160

The risk that time value may erode the premium of an equity option even while the underlying issuer remains financially sound is an example of:

- ✗ **A)** interest rate risk.
- ✗ **B)** reinvestment risk.
- ✓ **C)** capital risk.
- ✗ **D)** currency risk.

Explanation

Capital risk is generally associated with equity instruments, such as common stock, and equity-related derivatives, such as options. It is the risk that invested dollars can be lost as the result of circumstances unrelated to an issuer's financial strength.

Reference: 15.3.2.2 in the License Exam Manual

Question #206 of 214

Question ID: 607310

For dividends to be taxed as qualified dividends, the dividend paying investment must be held for

- ✗ **A)** more than 120 days
- ✗ **B)** at least 30 days
- ✗ **C)** at least 45 days
- ✓ **D)** more than 60 days

Explanation

In order to be taxed as qualified dividends, the investment must have been held for more than 60 days (at least 61 days).

Reference: 15.5.4.2 in the License Exam Manual

Question #207 of 214

Question ID: 607234

For tax-reporting purposes, qualified dividends are considered to be what type of income?

- ✗ **A)** Passive.
- ✗ **B)** Earned.
- ✗ **C)** Phantom.
- ✓ **D)** Portfolio.

Explanation

Portfolio income includes dividends, interest, and net capital gains derived from the sale of securities.

Reference: 15.5.3.3 in the License Exam Manual

Question #208 of 214

Question ID: 607288

If a municipal bond maturing in 10 years is bought for 110, its cost basis at the end of the sixth year is:

- ✗ **A)** 106.
- ✗ **B)** 100.
- ✗ **C)** 101-½.
- ✓ **D)** 104.

Explanation

To establish the new cost basis, determine the amount of the premium to be amortized yearly. For this bond, the $100 premium is amortized over 10 years: $100 ÷ 10 = $10. Then, multiply the annual amortization amount by the number of years the bond is held ($10 × 6 = $60). Finally, subtract the amount of the amortized premium from the original cost of the bond ($1,100 − $60 = $1,040, or 104).

Reference: 15.5.7.1 in the License Exam Manual

Question #209 of 214

Question ID: 607197

What is a basic assumption in an active management investment style?

- ✗ **A)** There is no opportunity cost to investing.
- ✗ **B)** Asset allocation makes no difference.
- ✓ **C)** Some securities are mispriced and value can be captured through security selection.
- ✗ **D)** The market is efficiently priced and that will make an active management style effective.

Explanation

An investment manager using an active management investment style believes that by using investment expertise he can select securities that are undervalued to achieve superior returns over time.

Reference: 15.4.3 in the License Exam Manual

Question #210 of 214

Question ID: 607151

A customer wants to buy ABC bonds, and as his representative, you have advised him that the trade is unsuitable. If he decides to go ahead with the purchase, you must:

- ✗ **A)** not execute the trade.
- ✓ **B)** execute the trade specifically as the customer has directed you to do but mark it unsolicited.
- ✗ **C)** execute the trade only if the customer has previous trading experience in similar securities.
- ✗ **D)** execute the trade if FINRA approves.

Explanation

If a customer wishes to purchase a security that the registered representative feels is unsuitable, the trade may be executed if the customer specifically directs it. The ticket should be marked unsolicited.

Reference: 15.3.1 in the License Exam Manual

Question #211 of 214

Question ID: 607309

For the purpose of reporting sales to the IRS, which method available to investors by the IRS offers the most flexibility in anticipation of the investor's year-end tax needs?

- ✗ **A)** First in, first out (FIFO)
- ✓ **B)** Share identification
- ✗ **C)** None offer any flexibility in anticipation of year-end tax needs
- ✗ **D)** Average cost basis

Explanation

Share identification is the most flexible of the three methods. The investor keeps track of the cost of each share purchased and specifies which shares to sell based on his anticipated year-end tax needs. For investors, the idea is to minimize tax liability if able by limiting gains or maximizing loses in anticipation of what one's year-end tax liability might be.

Reference: 15.5.6.2 in the License Exam Manual

Question #212 of 214

Question ID: 607253

The effect of using the FIFO method for a sale of some of the securities that were purchased separately during a period of rising prices will be:

- ✗ **A)** an increase in the cost basis of the securities.
- ✓ **B)** an increase in the taxable profits of the investor.
- ✗ **C)** a decrease in the profits of the investor.
- ✗ **D)** a decrease in the tax liabilities of the investor.

Explanation

FIFO (first in, first out) is an inventory accounting term used to standardize the determination of which items are sold first. In this case, if different purchases are made of the same stock, and the per-share price is higher each time, then if a portion (but not the entire inventory) is sold at one price, the taxable gain will be maximized. If LIFO (last in, first out) were used, the taxable gain would be minimized, and the lower cost basis securities would remain in the portfolio.

Reference: 15.5.6.2 in the License Exam Manual

Question #213 of 214

Question ID: 607271

The IRS requires a bondholder to use straight-line amortization for the purpose of determining the annual:

- ✓ **A)** decrease to a premium bond's cost basis.
- ✗ **B)** increase to a premium bond's cost basis.
- ✗ **C)** increase to a discount bond's cost basis.
- ✗ **D)** decrease to a discount bond's cost basis.

Explanation

Premiums are amortized; discounts are accreted. For municipal bonds bought at a premium, the bondholder must adjust cost basis annually in such an amount that, if held to maturity, there is no reported capital gain or loss. The amortization is straight line, or the same amount must be amortized each year.

Reference: 15.5.7.1 in the License Exam Manual

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Question ID: 607112

If a registered representative owns a vacation home and wants to rent it out during the summer, which of the following statements is TRUE?

- ✗ **A)** Prior notification must be made to the member firm under the rules on outside affiliations.
- ✗ **B)** Prior notification must be made to the member firm under the rules on private securities transactions.
- ✓ **C)** No notification is required.
- ✗ **D)** No notification is required, provided the vacation home is located in the state where the member firm has its principal office.

Explanation

Rental income is passive income. Passive investments are excluded from the notification requirements of the outside affiliations rule. Similarly, renting a vacation home is not a private securities transaction.

Reference: 15.1.2.3 in the License Exam Manual