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 (PRINT)

**“BUSINESS INSURANCE BASICS”**

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# BUSINESS INSURANCE BASICS

## Self Study Examination

**Instructions:** This examination consists of 50 questions in multiple choice format. Four possible answers have been presented for each question. On your answer sheet indicate the best answer to each question. There is no penalty for guessing incorrectly.

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### SECTION I: FORMS OF DOING BUSINESS (9 Questions)

1. The sole proprietorship is:
  - A. The simplest way to organize a privately owned business.
  - B. A corporation which is entirely owned by the founder.
  - C. A tax entity with only one employee.
  - D. None of the above.
2. The primary advantage of the proprietorship as a form of doing business is:
  - A. Under common law it has a perpetual existence.
  - B. It is the simplest form of organization to form and operate.
  - C. The taxation of proprietorships is less complex than that of corporations.
  - D. A and C above.
3. The proprietorship is controlled by:
  - A. Its Board of Directors.
  - B. Its managing partner.
  - C. Its founding shareholder.
  - D. The proprietor
4. Regarding partnerships, it is true that;
  - A. The partnership is a separate tax entity
  - B. The partnership must file a tax return each year.
  - C. The partnership is not separate from its partners for taxation purposes.
  - D. B and C.
5. A disadvantage of both partnership organization and proprietorship organization is:
  - A. The personal assets of the proprietor and of the partners are available to creditors.
  - B. They do not operate under the guidance of a Board of Directors.
  - C. They cannot be as profitable as a corporation can.
  - D. All of the above.
6. When a proprietor dies,
  - A. The business continues operation, although new management may be required.
  - B. The assets and liabilities of the business are treated as part of the owner's estate.
  - C. It is the responsibility of the administrator to close down the business, wrapping up its affairs.
  - D. B and C
7. When a proprietorship business terminates, regardless of the reason, some of the repercussions are:
  - A. There is no effect on local employment except for the jobs which are lost by employees of the terminated business.
  - B. The family of the business owner may suffer a loss of income.
  - C. There are no effects in the community.
  - D. A and C
8. Under common law, the death of a partner causes:
  - A. No interruption of the operation of the partnership.
  - B. The remaining partners automatically succeed to the ownership of the deceased partner's interest.
  - C. The automatic dissolution of the partnership, under the supervision of a liquidating partner.
  - D. None of the above.

9. Which of the following statements regarding corporations is untrue?
- A. Corporations are formed under the authority of a state's corporation statute.
  - B. Ownership of a corporation is vested in the shareholders of the corporation, who have no personal liability to the creditors of the corporation.
  - C. By law, corporations exist for a fixed period of time which can be extended.
  - D. None of the above.

**SECTION II: IMPACT OF DEATH ON THE BUSINESS ENTITY (12 Questions)**

10. Following the death of a sole proprietor, which of the following might occur if the survivors of the decedent attempt to continue the business without authority.
- A. The business may fail because the family members may not possess the expertise required to operate the business.
  - B. Financial failure as a result of an unauthorized attempt to continue operations may lead to litigation or disputes among the heirs of the decedent.
  - C. Financial failure of the business may subject the administrator to financial risk.
  - D. All of the above.
11. Following the death of a partner, which of the following may occur if the remaining partners decide to continue operation of the business without proper authority:
- A. The assets of the partners may be liable to newly created creditors of the partnership.
  - B. The assets of the partners may be subject to claims of the heirs of the deceased partner, if the partnership business should fail as a result of the unauthorized continuation.
  - C. A and B
  - D. None of the above.
12. Dissolution of a partnership following the death of a partner results in the liquidating partner winding up the affairs of the partnership and distributing the assets to:
- A. Creditors other than partners
  - B. Repay loans from partners
  - C. Repay capital contributions of the partners.
  - D. All of the above.

13. Following the death of the partners, the remaining partners may attempt to purchase the interest of the deceased partner. However, several problems may arise. Foremost among these is:
- A. Not all of the partners may wish to buy the interest.
  - B. The problem of placing a value on the deceased partner's interest in the partnership.
  - C. The paperwork burden required by the common law.
  - D. None of the above.
14. When a shareholder of a corporation dies
- A. The corporation does not necessarily cease operations in a manner similar to that of partnerships and proprietorships.
  - B. The corporation continues in operation, since by law its existence is perpetual.
  - C. The shares of the deceased shareholders are distributed to his heirs and legatees.
  - D. All of the above.
15. Which of the following are methods by which a deceased shareholder could transfer his interest according to prearrangement?
- A. By means of a buy-sell agreement with the remaining shareholders
  - B. By means of an agreement offering the remaining shareholders the first option to purchase the shares of the deceased shareholders.
  - C. A and B
  - D. Neither of the above
16. Regardless of the form of business, the death of a proprietor, partner or prominent shareholder may cause problems because:
- A. The heirs of the decedent may have different goals than the remaining shareholders, partners or employees of the business.
  - B. Continuation of the business is unwise and financially risky if the continuation is not authorized.
  - C. Unless continuation of the business has been planned for, the business may terminate.
  - D. All of the above.

**SECTION III: BUY-SELL AGREEMENTS  
(17 QUESTIONS)**

17. Many of the problems which occur upon the death of a proprietor or partner also occur in the context of death of a shareholder of a closed corporation, because:
- Closed corporations are merely partnerships
  - Closed corporations are merely proprietorships
  - Closed corporations, although they have adopted the formal corporate structure, may be quite similar in operation to partnerships or proprietorships.
  - All of the above.
18. Regardless of the form of business entity, continuation of the business following the death of a proprietor, prominent partner or shareholder will require:
- Sufficient expertise to operate the business
  - Sufficient capital to operate the business
  - Sufficient authorization to operate the business
  - All of the above
19. When a partner dies,
- Dissolution of the partnership is usually desired by the remaining partners.
  - Dissolution of the partnership is usually not desired by the remaining partners.
  - The motivations of the remaining partners may not be the same as that of the heirs of the deceased partner.
  - B and C.
20. A problem encountered following the death of a sole proprietor is:
- Continued operation of the business may be difficult because of poor recordkeeping prior to the death of the proprietor.
  - Selling the business may be difficult because there may be no liquid market for the business.
  - Sale of the business to a third party will usually be satisfactory to the heirs.
  - None of the above.
21. If a deceased proprietor desires that his business continue after his death, some affirmative plan must be in place. Often, proprietors
- Attempt to provide for continuation by an employee
  - Set forth continuation plan in their will.
  - Eliminate all problems by leaving specific authority for the administrator.
  - Do not do an adequate job of planning for the continuation of their business.
22. The primary planning tool to insure survival and continuation of the business is
- The buy-sell agreement
  - Provisions in the will of the proprietor, partner or shareholder.
  - The requirements of the common law.
  - All of the above.
23. Regarding buy-sell agreements, which of the following is untrue?
- The buy-sell agreement is a plan for continuing the business while providing for the heirs of the deceased proprietor, partner or shareholder.
  - Buy-sell agreements give sufficient authority for the continuation of the business following the death of the proprietor, partner or shareholder.
  - The use of a buy-sell agreement guarantees the elimination of all problems relating to the continuation of the business.
  - The buy-sell agreement provides a plan for the orderly transfer of the ownership interest of the deceased.
24. In the case of a proprietorship, the buy-sell agreement:
- Is set forth in writing.
  - Usually identify successor employee.
  - Identifies a fair price for the transaction, and provides a means of financing the purchase of the decedent's interest.
  - All of the above.
25. Even where a buy-sell agreement is used, it is possible that the plan will be difficult or impossible to carry out unless:
- A fair price for the business interest is identified in the agreement.
  - A plan for financing the transaction is set forth in the agreement.
  - A and B
  - None of the above.

26. In the case of a corporation, the buy-sell agreement may provide which of the following plans?
- A. The corporation or surviving shareholders must purchase the interest of the deceased shareholder.
  - B. The estate has the right, but not the obligation, to offer the decedent's shares to the remaining shareholders before offering it to any third party.
  - C. The corporation or the surviving shareholders may have an option to purchase the shares.
  - D. Any of the above.
27. Buy-sell agreements may be either funded or nonfunded. With regard to funded buy-sell agreements, which of the following statements is not true?
- A. The funded agreement is the most predictable, and most likely to be implemented.
  - B. The funded agreement is no more or less useful than the unfunded agreement.
  - C. The funded agreement may outline the use of life insurance to provide funds for effecting the transfer of the interest.
  - D. All of the above are true.
28. Regarding sale of a proprietorship interest by use of a funded buy-sell agreement, which of the following statements is untrue?
- A. The heirs of the proprietor are benefitted by receiving a fair price for his interest, even where there may not be a liquid market for the business.
  - B. The successor employee is benefitted by having the opportunity to own and continue a going business, and to purchase it at a fair price.
  - C. The creditors of the business are benefitted because the stability of the business is assured by providing for its continuation.
  - D. None of the above.
29. Methods of placing a value on the business for purposes of the buy-sell agreement include:
- A. Stating a fixed price in the agreement.
  - B. Calculating the adjusted book value of the enterprise.
  - C. Calculating the value based on capitalized earnings.
  - D. All of the above.
30. Where a partnership interest is to be sold under a buy-sell agreement, which of the following statements is untrue?
- A. Under an entity purchase arrangement, the partnership itself will purchase the interest of the deceased or retired partner.
  - B. Under a cross purchase arrangement, the remaining partners will purchase the interest of the deceased or retired partner.
  - C. The price of the transaction need not be fixed in the buy-sell agreement.
  - D. Either the entity purchase or cross purchase arrangement can be financed with life insurance contracts.
31. Where life insurance is used to finance the purchase and sale of a partnership interest under a buy-sell agreement, which of the following statements is true?
- A. Life insurance automatically provides adequate funds.
  - B. Under the entity purchase arrangement, fewer life insurance policies are required to be maintained.
  - C. Under the cross purchase arrangement, fewer life insurance policies are required to be maintained.
  - D. The entity purchase and cross purchase arrangements require identical numbers of insurance policies to be maintained.
32. Which of the following clauses should be included in the buy-sell agreement?
- A. Identification of the parties and the purpose of the agreement.
  - B. Options at retirement or resignation
  - C. Determining price and funding.
  - D. All of the above.
33. Which of the following clauses is not typically included in the buy-sell agreement?
- A. Identification of the insurance policies
  - B. Provision for adjustments of price and insurance
  - C. Provisions specifying the treatment of taxes.
  - D. All of the above.

34. In the case of closed corporations, the buy-sell agreement is typically used to:
- Require the corporation to buy, and the estate of a deceased shareholder to sell, the shares.
  - Provide the corporation or the surviving shareholders with the right, but not the obligation, to purchase the interest of a deceased or retired shareholder.
  - Provide the estate with the right to sell its shares, and with a market for the shares.
  - Any of the above.
35. Types of transactions which can be used include:
- Stock redemptions
  - Cross purchases
  - Optional buy-sell requirements
  - All of the above
36. In order to be sure that the intent of a corporate buy-sell agreement will be fulfilled, the agreement should include several clauses, including:
- Identification of the life insurance contracts which will be used, including ownership, premium payment responsibilities and beneficiary designations.
  - The price of the transaction, or the method and time by which and at which the price will be determined.
  - A and B
  - None of the above
37. The Internal Revenue Service will usually accept the price of the transaction as valid for estate tax purposes if the agreement specifies a price which is:
- Reasonable and can be substantiated by normal valuation methods.
  - The price reflects a value which has been agreed to by the parties.
  - The Service will always accept the price established in the buy-sell agreement.
  - The Service will always conduct its own audit to determine whether the price was fair and reasonable.

38. Generally, if the corporation has paid for stock, the payment will be treated as a dividend distribution, and therefore taxed at normal rates. Regarding corporate redemptions, which of the following statements is true?
- Section 302 of the Internal Revenue Code requires that all redemptions be taxed as dividends.
  - Section 302 of the Internal Revenue Code provides that complete redemptions are exempt from taxation as dividends.
  - Section 302 does not require that constructively owned shares be redeemed in order to qualify for the exemption.
  - None of the above.

#### **SECTION IV: BUSINESS USES OF LIFE INSURANCE (2 QUESTIONS)**

39. Regarding group life insurance offered as an employee benefit, which of the following is untrue?
- One of the most common forms is group term life insurance.
  - Group term life insurance usually is in a multiple of the employee's salary.
  - Group term life insurance is the only insurance the employee requires.
  - The group underwriting feature results in insurance being available without the necessity of evidence of insurance.
40. Which of the following plans providing cash value insurance is in common use?
- Flat value continuation
  - Retired lives reserve (RLR)
  - Paid up group
  - Group Universal Life (GULP)

#### **SECTION V: BUSINESS USES OF DEFERRED COMPENSATION, DISABILITY, KEY EMPLOYEE AND SPLIT DOLLAR PLANS (10 QUESTIONS)**

41. If a deferred compensation plan is qualified, it meets ERISA requirements with regard to:
- Eligibility and participation
  - Funding and benefit levels
  - Vesting
  - All of the above.

42. Which of the following describes the benefits of ERISA qualification of deferred compensation plans?
- A. Employer contributions are tax deductible
  - B. Accumulations in the fund are not taxed until withdrawal
  - C. Contributions to plans are not taxed to the employee until withdrawals begin
  - D. All of the above.
43. Employee benefit plans are employer sponsored plans that provide benefits to employees in the event of:
- A. Retirement
  - B. Death
  - C. Disability
  - D. Any of the above
44. Benefits are used to assist employers in meeting their "4-R" needs. Which of the following describes a corporation's 4-R requirements with regard to its employees?
- A. Recruit, reward, renegotiate and retire
  - B. Recruit, reward, retain and retire
  - C. Renew, retain, reward and reveal
  - D. Recruit, reward, reveal and repeat
45. Common, and popular, employee benefit plans include:
- A. Employee health insurance and disability insurance
  - B. Employee life insurance
  - C. Deferred compensation retirement plans
  - D. All of the above
46. ERISA requires that the following employees are eligible to participate in employer-sponsored qualified deferred compensation plans:
- A. Employees with less than one year of service (1000 hours)
  - B. Employees who are at least 21 years of age
  - C. Employees who are covered by collective bargaining agreements
  - D. Part time employees
47. Deferred compensation plans are either defined contribution or defined benefit plans. With regard to deferred compensation plans, which of the following statements is untrue?
- A. Defined contribution plans do not guarantee the level of benefits which will be available at retirement.
  - B. Defined benefit plans provide the employee with the security of knowing what his benefit will be.
  - C. Typically, defined contribution plans provide for faster vesting schedules than defined benefit plans do.
  - D. Defined contribution plans often provide for employee matching contributions.
48. Split dollar plans
- A. Are special life insurance plans only offered by a few providers
  - B. Are methods of purchasing life insurance under which the benefits, ownership and premiums are split between the employer and employee.
  - C. A and B
  - D. None of the above.
49. Types of split dollar plans which may be employed include:
- A. The collateral assignment method
  - B. The endorsement method
  - C. The reverse split dollar method
  - D. All of the above
50. Disability income plans provide:
- A. Replacement income for the disabled employee.
  - B. Sources of funding for disability buyout provisions of a buy-sell agreement
  - C. A and B
  - D. Neither A nor B