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JOURNAL DISCUSSION GUIDE
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401(k) Design: Contribution Formula, Plan Eligibility, and Vesting Choices

1. All of the following statements about choosing a contribution formula when designing a 401(k) plan are correct **EXCEPT**:
   A. When choosing a contribution formula, the plan sponsor must keep in mind the IRC Sections 415, 402(g), and 404 limits.
   B. One factor that will influence the contribution formula choice is the tax shelter needs of the business owners.
   C. In order to be sure to pass the actual deferral percentage (ADP) and actual contribution percentage (ACP) nondiscrimination tests, midsized and larger companies will mandate that salary deferrals for the business owners are at least 5 percent more than the expected average that nonhighly compensated employees contribute to the plan.
   D. When choosing a contribution formula, plan sponsors are often motivated by the desire to see that participants save enough for retirement.

2. All of the following statements about matching contributions in 401(k) plan design are correct **EXCEPT**:
   A. Many employers will not make a full matching contribution unless 6 percent is contributed by the employee.
   B. Choosing the amount of the match is predicated on a value judgment regarding what percentage of contributions will be most effective in maximizing the salary deferrals of rank-and-file employees.
   C. Two popular choices for matching contributions are 50 cents per dollar on the first 6 percent and dollar for dollar on the first 6 percent.
   D. Employers who implement a matching contribution provision in their 401(k) plan design cannot reduce or eliminate the match for a period of 5 years.

3. Which statement(s) about the four basic contribution formulas in 401(k) plan design is (are) correct?
   I. Plan designers will use an elective-deferrals-only option primarily when the 401(k) plan covers only the nonhighly compensated employees and a separate nonqualified plan is used to provide retirement benefits for highly compensated employees.
   II. The least popular choice for plan sponsors as to contribution formulas is to provide three types of contributions—elective deferrals, matching contributions, and nonelective deferrals—because of the expense and administrative complexity of including three options.
   A. I only
   B. II only
   C. Both I and II
   D. Neither I nor II

4. All of the following statements about the advantages of a safe harbor 401(k) plan are correct **EXCEPT**:
   A. A safe harbor 401(k) plan is exempt from many of the compliance requirements applicable to traditional 401(k) plans, such as ADP and ACP testing.
   B. A safe harbor 401(k) plan allows business owners to maximize their elective deferrals under the plan.
   C. A safe harbor 401(k) plan is deemed to meet the IRC Section 416 top-heavy rules.
   D. Safe harbor 401(k) plans are not required to satisfy any notice requirements.

5. All of the following statements about eligibility requirements for a 401(k) plan are correct **EXCEPT**:
   A. Age 30 is the oldest eligibility age for entry into a company's 401(k) plan.
   B. "One and 21" are common service and age components because they eliminate some costs by keeping younger and less tenured employees out of the plan.

C. A plan sponsor many decide to include 18-year-olds into the plan as a way to maximize benefits for relatives of the business owners.
D. Determining the plan's entry date is one of the three eligibility requirement decisions a plan sponsor must make.

6. True or False. Elective employee contributions and safe harbor employer contributions are always full vested.
   A. True B. False

7. All of the following statements about choosing a vesting schedule when designing a 401(k) plan are correct **EXCEPT**:
   A. For employers who experience employee turnover within the first 2 years of employment, a 2-year eligibility requirement with full and immediate vesting after 2 years is advised.
   B. A 3-year cliff vesting schedule is considered a good choice for employers with employees who are primarily in the 18 to 22 age range.
   C. If an employer tends to experience turnover in the 3- to 6-year timeframe, a 2- through 6-year graded vesting schedule might be considered.
   D. When designing the vesting schedule, the choice is typically made to allow participants to be fully vested in employer contributions at either their death or disability.

Planning for Capital Gains and Losses

8. All of the following statements about the basis of an asset are correct **EXCEPT**:
   A. The cost of an asset when it is purchased becomes its basis for tax purposes.
   B. The cost basis of real estate includes the purchase price plus capital improvements.
   C. Settlement costs can be included in the cost basis of a new home.
   D. The cost basis of stocks and bonds can be increased by the amount of annual dividends.

9. What is the amount of net loss that can be netted against ordinary income pursuant to IRC Section 1211(b)?
   A. $3,000
   B. $3,500
   C. $5,000
   D. $8,000 indexed for inflation

10. Which statement(s) about tax planning for inherited or gifted property is (are) correct?
    I. If property is inherited from a decedent, the client is deemed to have held the property for more than one year which allows him/her to receive long-term capital gains treatment upon sale of the property.
    II. Clients who receive property as a gift add the donor's holding period to their own holding period for purposes of determining whether the gift will be taxed at ordinary income or capital gains rates.
    A. I only C. Both I and II
    B. II only D. Neither I nor II

11. All of the following statements about the tax strategy known as loss harvesting are correct **EXCEPT**:
    A. Loss harvesting works well when the client's assets are declining and will not recover value.
    B. Loss harvesting is limited by the wash sale rule.
    C. Advisors need to caution clients against loss harvesting if it is detrimental to their investment plan and growth of their portfolio.
    D. Loss harvesting can be used effectively with both taxable and nontaxable accounts, such as 401(k) or 403(b) plans.

Pharmacy Benefit Managers

12. All of the following statements about the use of pharmacy benefit managers (PBMs) are correct **EXCEPT**:
    A. Insurance plan sponsors hire PBMs to reduce direct costs of pharmaceuticals.
    B. PBMs contract with state Medicaid departments to manage pharmacy costs for Medicaid enrollees.

C. PBMs create plan formularies that describe which drugs are covered under an insurance plan for each condition.
D. Federal laws prohibit the use of PBMs by Medicare Part D plans and Medicare Advantage drug plans.

13. Which statement(s) about pharmacy benefit managers (PBMs) is (are) correct?
    I. The Patients Right to Know Drug Prices Act was enacted in 2018 to address concerns about the lack of transparency in PBMs business transactions.
    II. There is a concentrated market for PBM services with just three firms providing 66 percent of the market.
    A. I only   C. Both I and II
    B. II only   D. Neither I nor II

Internal Revenue Code (Sub)Section 101(j)–Unintended Consequences, Unexpected Opportunities

14. All the following statements about IRC Section 101(j) are correct **EXCEPT**:
    A. IRC Section 101(j) was enacted to correct perceived abuses related to employer-owned life insurance.
    B. The general rule of IRC Section 101(j) provides that all death proceeds of employer-owned life insurance are to be treated as taxable income to the employer less the basis in the contract.
    C. One exception to the general rule of Section 101(j) is for an insured who at the time the policy is issued is a director of the company purchasing the policy.
    D. IRC Section 101(j) grants automatic safe harbor status for a company's chief executive officer and chief financial officer as to taxation of employer-owned life insurance benefits.

15. True or False. IRC Section 101(j)(2)(A) creates an exception for employer-owned life insurance policies with a death benefit of $100,000 or less.
    A. True   B. False

Final Rules Developed for the Section 199A Deduction

16. All of the following statements about IRC Section 199A are correct **EXCEPT**:
    A. The new provision, enacted by the Tax Cut and Jobs Act, provides for a deduction of up to 20 percent for qualifying income.
    B. In response to some commenters, the IRS included regulated investment companies in the definition of a relevant pass-through entity for purposes of Section 199A.
    C. In 2019, the IRS and Treasury issued T.D. 9847 which provides final rules clarifying several areas related to the new 199A deduction.
    D. Reg. Section 1.199A-1(b)(3) defines net capital gain for purposes of Section 199A as the excess of net long-term capital gain over the net short-term capital loss plus any qualified dividend income per IRC Section 1(h)(11)(B) for the tax year.

17. All of the following statements about the safe harbor guidance in the area of rental real estate provided by the IRS in Notice 2019-07 are correct **EXCEPT**:
    A. In order to qualify under the safe harbor provision, for tax years that begin after December 31, 2022, the taxpayer must perform 500 or more hours of rental services per year.
    B. In order to qualify under the safe harbor provision, separate books and records must be maintained for each rental real estate enterprise.
    C. The guidance defines real estate enterprises as interest in real property held for the production of rents.
    D. For tax years beginning prior to January 21, 2023, the taxpayer must perform 250 or more hours of rental services per year with respect to the rental enterprise to qualify under the safe harbor provision.

18. All the following statements about the Section 199A final regulations (T.D. 9847) are correct **EXCEPT**:
    A. The final regulations contain a *de minimis* rule for those businesses that are involved in only a relatively small amount of specified service trade or business (SSTB)-type activity.
    B. Under the final regulations, relevant pass-through entities (RPEs) are required to provide certain information, such as the owner's share of qualified business income (QBI) for each business, to the owners on the K-1.
    C. The final regulations clarify that a trust takes the deduction related to QBI items that are retained by a trust, while the grantor or beneficiary of the trust would take the deduction related to QBI items that are passed out as part of distributable net income (DNI).
    D. The effective date for the provisions of T.D. 9847 is January 1, 2020.

Special Needs Estate Planning—Seven Overlooked Challenges

19. All the following statements about the Social Security disabled child's benefit are correct **EXCEPT**:
    A. This benefit is available to disabled children of parents whose combined adjusted gross income (AGI) does not exceed $100,000.
    B. This benefit is for disabled children regardless of their age as long as their disability began before the age of 22 and they are single.
    C. One of the eligibility triggers for the benefit is that one parent of the disabled child who had worked and paid FICA dies.
    D. The Social Security disabled child's benefit is designed to provide a disabled person with monthly income.

20. Which statement(s) regarding creating a special needs trust for the benefit of a disabled child is (are) correct?
    I. Special needs trusts are used to make a gift or leave an inheritance to a disabled child without jeopardizing the child's eligibility for Medicaid.
    II. A self-settled special needs trust must contain a provision to pay the state at the child's death for expenses paid by Medicaid.
    A. I only
    B. II only
    C. Both I and II
    D. Neither I nor II

21. All the following statements about funding a special needs trust are correct **EXCEPT**:
    A. In determining adequate funding for a special needs trust, it is important to have a good estimate of the expenses the parents are spending on their disabled child.
    B. Funding considerations for a special needs trust must take into account the IRC Section 162 penalty tax triggered by trusts with more than $5 million in assets.
    C. When funding a special needs trust, expenses associated with transitioning a child from the parent's care to a successor caregiver must be considered.
    D. A special needs trust can be funded with anything of value, such as real estate, distributions from a retirement account, or other savings or investments.

Administering Employment-Related Split-Dollar Arrangements

22. All of the following statements about equity loan regime split-dollar plans are correct **EXCEPT**:
    A. In the equity loan regime split-dollar arrangement, the employee owns the policy and the employer pays the premiums.
    B. IRS regulations require that the loan in an equity loan split-dollar plan be a demand loan that allows the employer to demand return of its funds at any time.

C. An equity loan split-dollar arrangement creates what is called imputed interest income that is taxed to the employee.
D. Most split-dollar loan arrangements are nonrecourse.

23. True or False. In a nonequity economic benefit split-dollar arrangement, the employer typically owns the policy and pays the premiums, but the employee has the right to name a beneficiary.
A. True B. False

24. Which statement(s) about the value of coverage in a nonequity economic benefit split-dollar arrangement is (are) correct?
I. The value of coverage in a nonequity economic benefit split-dollar plan is taxed to the employee based on the annual term insurance rates and the amount of the insurance in effect on the last day of the employee's tax year.
II. Employers can use IRS Table 2001 rates to determine the value of the life insurance, i.e., the economic benefit, to the employee.
A I only C. Both I and II
B. II only D. Neither I nor II

401(k) Plans Are Changing Investors' Experiences

25. According to statistics from the Investment Company Institute, at year-end 2018, what amount of retirement assets were invested in 401(k) plans?
A. $7.5 trillion C. $5.2 trillion
B. $6.8 trillion D. $90 billion

26. All of the following statements about milestones in the history of 401(k) plans are correct **EXCEPT:**
A. Automatic enrollment of participants into 401(k) plans was first used in 1984.
B. The Tax Cuts and Jobs Act of 2017 significantly expanded the ability of workers aged 40 or older to make "catch-up" contributions.
C. The Roth option for 401(k) plans was introduced by the Pension Protection Act of 2006.
D. The introduction of target date funds in 1994 was recognition that 401(k) plan participants wanted guidance on asset allocation and rebalancing from an investment professional.

27. All of the following statements about 401(k) plan investment options are correct **EXCEPT:**
A. On average, large 401(k) plans in the BrightScope Defined Contribution Plan Database offered participants more than 20 investment options.
B. According to BrightScope, fewer than 15 percent of large 401(k) plans included domestic bond funds in their investment lineups.
C. In plan year 2015, 79.5 percent of large 401(k) plans included target date funds in their investment lineups.
D. 401(k) plan sponsors often offer index as well as active investment options.

28. Which statement(s) about the use of target date funds in 401(k) plans (is) are correct?
I. EBRI/ICI 401(k) plan data indicate that at year end 2006, a modest 22 percent of 401(k) plans offered target date funds in their investment lineups.
II. Participant use of target date funds has risen from 19 percent of 401(k) plan participants in 2006 to over 60 percent in 2016.
A. I only C. Both I and II
B. II only D. Neither I nor II

29. All of the following statements identify key takeaways from an analysis of the more than 27 million 401(k) plan participants' accounts in the EBRI/ICI database **EXCEPT:**
A. The majority of 401(k) plan assets are invested in equities.
B. The vast majority of 401(k) plan participants hold at least some equity investments in their 401(k) plan accounts.

C. The age of the 401(k) plan participant has very little bearing on the way assets are allocated within 401(k) plan accounts.
D. Recently hired 401(k) plan participants rely more on prepackaged investment allocations, typically using target date funds.

30. According to Figure 2, in 2015, what percentage of large 401(k) plans included automatic enrollment, employment contributions, and outstanding loans as plan features?
A. 23 percent
B. 32 percent
C. 35 percent
D. 42 percent