DC-3: Advanced Compliance and Administration Topics

Practice Exam

2020 DC-3 Practice Exam

Question 1:
Which of the following statements regarding leased employees under a multiple employer plan is/are TRUE?

I. Common ownership must be established between the recipient and the leasing organization to allow the leased employee to participate.

II. A leased employee's years of service with all participating employers are aggregated for determining eligibility under IRC §401(a).

III. Contributions from all participating employers are aggregated for computing the leased employee's annual addition under IRC §415.

A. I only
B. II only
C. I and III only
D. II and III only
E. I, II and III

Question 2:
All of the following are conditions that must be satisfied for an individual to be considered a leased employee, EXCEPT:

A. The recipient must have primary direction or control over the individual's services
B. Contributions under the leasing organization's plan must be treated as provided only by the leasing organization
C. There must be an agreement between the leasing organization and the recipient for the individual's services
D. The leasing organization must be the common law employer of the individual
E. The individual must be providing services on a substantially full-time basis for at least a year

Question 3:
Which of the following is/are requirements for an employee to be deemed a leased employee?

I. Services must be performed for at least six months on a substantially full-time basis
II. Services must be performed under an agreement between the recipient employer and the leasing organization
III. Services performed must be under the primary control or direction of the recipient employer

A. I only
B. II only
C. I and III only
D. II and III only
E. I, II and III

Question 4:
Which of the following is/are conditions that must be satisfied in order for an individual to be treated as a leased employee under IRC §414(n)?

I. Services performed must be under the primary control or direction of the recipient employer.
II. Services must be performed under an agreement between the recipient employer and the leasing organization.
III. Services must be performed for at least six months on a substantially full-time basis.

A. I only
B. III only
C. I and II only
D. II and III only
E. I, II and III

Question 5:
Based on the following information, determine the self-employed individual's earned income under the profit sharing plan:

Schedule C Income	$180,000
Self-Employment Tax	$9,500
Contributions for Employees	$24,000
Contributions for Self-employed Individual	$10,000

The Schedule C income reflected above is before adjustments.

A. $136,500

B. $141,250

C. $146,500

D. $151,250

E. $180,000

Question 6:
All of the following statements regarding multiemployer plans are TRUE, EXCEPT:

A. A multiemployer plan requires a collective bargaining agreement between an employee organization and two or more unrelated employers.

B. One Form 5500 is filed for a multiemployer plan rather than for each participating employer.

C. If the multiemployer plan also covers nonunion employees, the portion covering nonunion employees must be disaggregated and tested for coverage.

D. A multiemployer plan may use a prototype plan or volume submitter plan as they both accommodate multiemployer plans.

E. For coverage testing a plan covering nonunion employees is disaggregated from the portion covering union employees.

Question 7:
All of the following statements regarding S Corporations are TRUE, EXCEPT:

A. An S Corporation may have more than one class of stock.

B. An S Corporation is a corporation that has made an election to be taxed as a partnership.

C. An S Corporation can have no more than 100 shareholders.

D. An ESOP may be a shareholder of an S Corporation.

E. Shareholders in an S Corporation may be paid compensation as an employee, subject to W-2 reporting.

Question 8:
Which of the following statements regarding QSLOB testing is/are TRUE?

I. The plan may test coverage under IRC §410(b) separately for each QSLOB only if it first satisfies the nondiscriminatory classification test on an employer-wide basis.
II. The plan may perform the annual additions limit separately for each QSLOB.
III. The plan may perform top-heavy testing separately for each QSLOB.

A. I only
B. II only
C. I and III only
D. II and III only
E. I, II and III

Question 9:
All of the following statements regarding the IRC §1563 controlled group attribution rules applying to adult children (age 21 or older) are TRUE, EXCEPT:

A. A parent is attributed ownership in all businesses held by an adult child if attribution requirements are met in at least one of the businesses.
B. A parent is attributed ownership in a business held by the child only if the parent owns more than 50% of that business.
C. A child is attributed ownership in a business held by a parent only if the child owns more than 50% of that business.
D. Both direct ownership and stock attribution apply when determining ownership interest.
E. Attribution rules are different for controlled group purposes than for ASG purposes.

Question 10:
All of the following statements regarding controlled group attribution rules are TRUE, EXCEPT:

A. A parent who owns 75% of a business is attributed the adult child's ownership in that business.
B. A parent is attributed the ownership of a business held by a minor child.
C. A father-in-law is attributed the ownership of a business held by a daughter-in-law.
D. In general, an individual's ownership is attributed to the spouse.
E. A grandparent who owns 60% of a business is attributed the grandchild's ownership in that business.

Question 11:
All of the following statements regarding ASGs are TRUE, EXCEPT:

A. SEPs and SIMPLE 401(k) plans are exempt from ASG rules.

B. All ASG members are treated as a single employer when identifying HCEs.

C. All ASG members are treated as a single employer when determining IRC §415 limits.

D. With all ASG members is considered for vesting purposes.

E. Service with all ASG members is considered for eligibility purposes.

Question 12:
All of the following statements regarding controlled groups are TRUE, EXCEPT:

A. If the common control test is satisfied, a brother-sister controlled group exists.

B. When one business owns at least 80% of one or more other business, a parent-subsidiary controlled group exists.

C. An organization that owns more than 50% of a subsidiary is a parent-subsidiary controlled group for purposes of applying the annual additions limit under IRS §415.

D. A person that owns 85% of two businesses satisfies the brother-sister common control test.

E. A brother-sister controlled group may only have five or fewer common owners.

Question 13:
All of the following perform professional services and organize as professional service organizations for ASG designations, EXCEPT:

A. Chiropractors

B. Dentists

C. Optometrists

D. Veterinarians

E. Zoologist

Question 14:
Based on the following information, determine participant K's ownership interest, including attribution, for an affiliated service group determination:

Individual	Ownership % in Company Z
K	55%
K's spouse	5%
K's child	5%
K's parent	10%
K's grandparent	25%

A. 55%
B. 60%
C. 65%
D. 75%
E. 100%

Question 15:
All of the following statements regarding compensation under IRC §415 are TRUE, EXCEPT:

A. This compensation must be used to determine key employees.
B. IRC §415 compensation is used to determine certain minimum contributions (e.g., gateway contributions) that must go to participants in plans that use cross-testing.
C. IRC §415 compensation is used to calculate minimum benefits or contributions for non-key employees under top-heavy plans.
D. Elective deferrals under a 401(k) arrangement, a 403(b) program or a SARSEP are included in determining IRC §415 compensation.
E. IRC §415 compensation is based on the plan year.

Question 16:
Which of the following statements regarding compensation under IRC §414(s) is/are TRUE?

I. The definition of compensation will not be considered discriminatory merely because it includes elective deferrals to an IRC §401(k) plan.

II. The definition of compensation will not be considered discriminatory merely because it excludes compensation which was earned prior to the date an employee becomes a participant in the plan.

III. The definition of compensation will not be considered discriminatory merely because it excludes compensation that applies only to HCEs.

A. I only
B. III only
C. I and II only
D. II and III only
E. I, II and III

Question 17:
Which of the following statements regarding the employer deduction in a short plan year is/are TRUE? The employer's taxable year is unchanged.

I. The employer will need to designate for which plan year the contribution is made.
II. The computation of the deduction is not affected.
III. The applicable compensation dollar limit under IRC §401(a)(17) is prorated.

A. I only
B. III only
C. I and II only
D. II and III only
E. I, II and III

Question 18:
All of the following are methods to pass coverage testing under IRC §410(b), EXCEPT:

A. Satisfying the ratio percentage test
B. Satisfying the average benefit test
C. Using snapshot testing
D. Relying on the three-year testing cycle
E. Satisfying the nondiscriminatory classification test

Question 19:
Based on the following information, determine the participant's average benefit percentage used in performing the general test for the employer's money purchase plan:

- Benefit percentage derived from the money purchase contribution is 8.0%.
- Benefit percentage derived from forfeitures allocated in the money purchase plan is 1.5%.
- Benefit percentage derived from a profit sharing contribution in the employer's separate profit sharing plan is 5.8%.
- Benefit percentage derived from pre-tax elective contribution in the employer's separate 401(k) plan is 9.0%.
- Benefit percentage derived from a matching contribution in the employer's separate 401(k) plan is 4.5%.

A. 8.0%
B. 9.5%
C. 15.3%
D. 24.3%
E. 28.8%

Question 20:
All of the following statements regarding otherwise excludable employees for coverage testing are TRUE, EXCEPT:

A. Testing otherwise excludable employees separately is an election made each plan year.
B. A profit sharing plan may define otherwise excludable employees to be employees who are currently eligible for the plan but would be excluded if the plan imposed a two-year eligibility requirement.
C. The employer may not elect to test otherwise excludable HCEs with the statutory group for coverage.
D. A plan may disaggregate otherwise excludable employees for the 401(k) component and not for the 401(m) component.
E. An employee who has not satisfied one year of service may be considered otherwise excludable.

Question 21:
Which of the following statements regarding permissive aggregation for coverage testing is/are TRUE?

I. Plans must have the same plan year to be permissively aggregated.

II. Plans permissively aggregated for coverage testing must also be permissively aggregated for nondiscrimination purposes.

III. Permissive aggregation may be useful if one of an employer's plans fails the ratio percentage test and the employer does not want to use the average benefit test for that plan.

A. I only

B. III only

C. I and II only

D. II and III only

E. I, II and III

Question 22:
All of the following statements regarding coverage testing when an acquisition takes place are TRUE, EXCEPT:

A. A plan that satisfies coverage at the time of an acquisition of a related group member is deemed to meet coverage during a transition period after the acquisition.

B. The transition period for satisfying coverage testing begins on the date of the transaction.

C. The transition period for satisfying coverage testing ends on the first day of the next plan year beginning after the transactions.

D. The transition period applies if there is no significant change in coverage during the transition period, other than change from acquisition.

E. The plan sponsor may elect to apply the coverage tests during the transition period.

Question 23:
Based on the following information, determine the number of rate groups for purposes of the nondiscrimination test under IRC §401(a)(4):

	Benefit %
HCE 1	5.25
HCE 2	2.50
HCE 3	15.50
HCE 4	2.50
HCE 5	5.25

A. 1
B. 2
C. 3
D. 4
E. 5

Question 24:
All of the following statements regarding benefits, rights and features subject to nondiscrimination testing are TRUE, EXCEPT:

A. The right to make rollover contributions into a plan is an example of a right or a feature.
B. Current availability is tested under the nondiscriminatory classification test of the average benefit test.
C. A benefit, right or feature, which is currently available, satisfies the nondiscrimination requirement even if it is not effectively available.
D. The right to direct investments in a plan is an example of a right or feature.
E. An ancillary benefit must satisfy the availability test.

Question 25:
Which of the following statements regarding cross-testing defined contribution plans under IRC §401(a)(4) is/are TRUE?

I. Cross-testing uses EBARs to analyze the benefit that would be generated from the allocations as if the plan were a defined benefit plan.

II. Cross-testing recognizes that a younger participant has more years for contributions to grow into a meaningful benefit at retirement than an older participant.

III. A participant's EBAR is equal to the allocation for the participant divided by the participant's compensation.

A. I only

B. III only

C. I and II only

D. II and III only

E. I, II and III

Question 26:
Based on the following information, determine the EBAR based on cross-testing contributions as benefits:

Annual Compensation	$160,000
Allocation	$40,000
Actuarial Factor	.008784

A. 2.50%

B. 2.85%

C. 8.78%

D. 25.00%

E. 28.46%

Question 27:
Based on the following information, determine the minimum allocation to the NHCE necessary to satisfy the gateway contribution test for cross-testing:

Participant	Compensation	Allocation
HCE1	$100,000	$12,000
HCE2	$100,000	$6,000
NHCE	$50,000	

A. $1,000
B. $1,500
C. $2,000
D. $2,500
E. $3,000

Question 28:
All of the following statements regarding aggregation, disaggregation and restructuring of plans for nondiscrimination testing are TRUE, EXCEPT:

A. Each disaggregated portion of the plan is treated as a separate plan.
B. If the plan passes coverage without being aggregated with another plan of the employer the contributions are tested for nondiscrimination separately from any other plan the employer maintains.
C. The nondesign-based safe harbor for uniform points plans is an available testing method for a component plan.
D. If you permissively aggregate two plans to pass coverage testing you must also permissively aggregate the plans when testing nondiscrimination.
E. No special plan language is needed to restructure the plan into component plans for testing purposes.

Question 29:
All of the following statements regarding coverage under IRC §410(b) and nondiscrimination under IRC §401(a)(4) are TRUE, EXCEPT:

A. Coverage testing is a requirement to cover a nondiscriminatory group of employees in the plan.

B. Whatever method is used to test coverage (i.e., annual testing or quarterly testing) must also be used to test nondiscrimination.

C. If a plan passes coverage without being aggregated with another plan then contributions are tested for nondiscrimination separately from another plan maintained by the employer.

D. A plan with a safe-harbor allocation formula must pass ADP nondiscrimination testing.

E. A plan that uses restructuring to pass coverage must also use it to pass nondiscrimination.

Question 30:
Which of the following statements regarding stock bonus plans is/are TRUE?

I. Benefits are distributable in employer stock.
II. Contributions may be made in the form of the plan sponsor's stock.
III. Put options are available to the participants.

A. II only

B. III only

C. I and II only

D. I and III only

E. I, II and III

Question 31:
All of the following statements regarding ESOPs are TRUE, EXCEPT:

A. Permitted disparity may not be used when allocating ESOP contributions.

B. An ESOP may not include a 401(k) elective deferral feature.

C. In some cases, the tax deductible contribution to a leveraged ESOP may exceed the 25% deductible limit.

D. The plan may pay no commissions on the sale of employer stock.

E. The plan sponsor of a leveraged ESOP may be able to deduct the amount of loan interest.

Question 32:
Based on the following information, determine the number of shares in the ESOP that are currently available for diversification:

Participant A's account contains 20,000 shares valued at $5 per share.
Participant A is age 58 with 25 years of participation.
In the last two years Participant A diversified a total of 4,000 shares valued at $2 per share.

A. 1,000
B. 2,000
C. 3,400
D. 3,800
E. 5,000

Question 33:
All of the following statements regarding a leveraged ESOP are TRUE, EXCEPT:

A. The ESOP may delay distributions until the loan is completely repaid.
B. Through a leveraged ESOP the employer may have access to additional funds, such as those needed for expansion, on a tax-favored basis.
C. When an ESOP borrows to purchase stock, the bank may require additional security for the loan other than the stock that is purchased with its proceeds.
D. Dividends paid on unallocated stock held in the suspense account may be used to make repayments on that loan.
E. The ESOP loan must be for the primary benefit of the participants and beneficiaries.

Question 34:
All of the following options are not available to an S corporation that sponsors an ESOP, EXCEPT:

A. Tax deferral by shareholders of the S corporation on the sale of stock to an ESOP under IRC §1042
B. Expanded deduction rules under IRC §404 provided to leveraged ESOPs
C. Expanded allocation limits under IRC §415 provided to leveraged ESOPs
D. Deductible dividends
E. Ability to borrow money to acquire employer securities

Question 35:
All of the following statements regarding an ESOP IRC §1042 transaction are TRUE, EXCEPT:

A. At least 30% of the company stock must be sold to the ESOP to be eligible for the transaction.
B. The shareholder must reinvest the proceeds from the sale into equity or debt instruments of other unrelated U.S. companies.
C. Only stock of a C corporation that sponsor's the ESOP is eligible for the transaction.
D. The shareholder is taxable on any gain from the initial transaction at the time of the sale.
E. The shareholder selling the stock must have owned it for at least three years prior to the sale.

Question 36:
All of the following statements regarding distributions from an ESOP are TRUE, EXCEPT:

A. Generally, ESOP participants have the right to demand that their entire account be distributed in the form of employer securities.
B. A put option permits the holder of the stock to demand that the company buy back the stock at the current fair market value.
C. The ESOP does not need to distribute stock when the company by laws limit stock ownership to the ESOP and employees of the company.
D. For separations due to retirement the participant must have the right to elect a distribution within one year after the fifth plan year following their separation.
E. S corporations are exempt from distributing benefits in the form of stock.

Question 37:
Which of the following is/are actions that result in a person being considered a fiduciary of a plan?

I. Exercising any discretionary authority or control over the plan's management and administration
II. Exercising any discretionary authority or control over the decision to make contributions to the plan, based on company profitability
III. Rendering investment advice with respect to plan assets for a fee

A. I only
B. II only
C. I and III only
D. II and III only
E. I, II and III

Question 38:
All of the following statements regarding fiduciary liability are TRUE, EXCEPT:

A. A fiduciary may avoid liability for a breach committed by another fiduciary by resigning as a plan fiduciary.
B. A fiduciary may be required to pay the plan any profits earned by the fiduciary through the use of plan assets involved in a breach.
C. A fiduciary that knowingly conceals or does not make a reasonable effort to remedy a breach may be liable for the breach.
D. A fiduciary is personally liable for any breach that he or she directly commits.
E. ERISA §404(c) can significantly limit fiduciary liability resulting from a participant’s investment direction of the assets allocated to his or her account.

Question 39:
All of the following statements regarding fiduciary responsibility are TRUE, EXCEPT:

A. Fiduciaries must act solely in the interest of participants and beneficiaries.
B. Fiduciaries must ensure that plan investments are diversified so as to minimize the risk of large losses.
C. Fiduciaries must meet market rates of return within an acceptable range of like funds.
D. Fiduciaries must ensure that fees paid by the plan are reasonable.
E. Fiduciaries must carry out their duties with care, skill, and prudence.

Question 40:
Which of the following statements regarding prohibited transactions is/are TRUE?

I. An excise tax is imposed on the disqualified person who engages in a prohibited transaction.
II. A prohibited transaction is corrected by undoing the transaction to the extent possible and placing the plan in the financial position it was in prior to the transaction.
III. An additional tax of 100% is imposed if the prohibited transaction is not corrected within a certain time period after notification by the IRS.

A. I only
B. III only
C. I and II only
D. II and III only
E. I, II and III

Question 41:
All of the following statements regarding prohibited transactions are TRUE, EXCEPT:

A. A prohibited transaction does not disqualify a plan under IRC §401(a).

B. The prohibited transaction rules do not apply to participant-directed investments.

C. Excise taxes apply for each year that a prohibited transaction remains uncorrected.

D. If a disqualified person enters into a prohibited transaction they are required to reverse the transaction in such a way to put the plan back into the condition it would have been in if the transaction had not taken place.

E. In some cases, the tax on a prohibited transaction may reach 100%, if the transaction is not corrected.

Question 42:
All of the following are exemptions from the prohibited transaction rules, EXCEPT:

A. Purchase by the plan of an office building in which the plan sponsor resides

B. Loans by the sponsoring employer to an ESOP

C. Purchase of life insurance where the insurer is the plan sponsor

D. Loan to a participant

E. Investing in qualified employer securities

Question 43:
All of the following are considered prohibited transactions, EXCEPT:

A. The contribution of property owned by the sponsoring employer to a defined benefit plan

B. The contribution of employer securities to a profit sharing plan as the annual employer contribution

C. A fully secured $10,000 loan from a plan to the sponsoring employer, bearing interest at the current rate of prime plus 2%

D. The late deposit of elective deferrals to a plan

E. The lease, to the sponsoring employer, of a printing press owned by the plan

Question 44:
Which of the following statements regarding the consequences for violating the ERISA §408(b)(2) plan sponsor fee disclosure requirements is/are TRUE?

I. The service provider may have to return to the plan any fees paid.
II. The responsible plan fiduciary can be liable for a breach of fiduciary duty.
III. The service provider will be liable for a 15% excise tax on the amount of fees charged.

A. I only
B. III only
C. I and II only
D. II and III only
E. I, II and III

Question 45:
All of the following are covered service providers under ERISA §408(b)(2) fee disclosure regulations, EXCEPT:

A. Someone who enters into a contract with a plan and reasonably expects to receive $1,000 or more in compensation for services to the plan
B. Someone who provides services as a fiduciary to the plan
C. An investment platform that provides services for a fee to the plan
D. A service provider who receives compensation only from the plan sponsor
E. An affiliate of the covered service provider

Question 46:
All of the following are parties-in-interest, EXCEPT:

A. A 20% partner of the plan sponsor
B. A 15% partner of a service provider to the plan
C. An officer of the plan sponsor
D. The spouse of a fiduciary to the plan
E. A participant who may direct their investments

Question 47:
All of the following are notice requirements applicable to distributions in excess of the cash-out limit, EXCEPT:

A. A copy of the plan's administrative policy regarding the timing of distributions

B. If QJSA rules apply, an explanation of the relative value of the optional form of benefit compared to the value of the QJSA

C. An explanation of benefit payments

D. An explanation that the participant has the right to delay distribution until at least normal retirement age

E. The required IRS direct rollover notice

Question 48:
All of the following statements regarding life insurance in defined contribution plans are TRUE, EXCEPT:

A. A plan may allow for the purchase of whole life insurance if the premiums are less than 50% of the cumulative contributions and forfeitures allocated to the individual participant's account.

B. Universal life insurance is considered term insurance for purposes of the percentage limitations of the incidental benefit test.

C. The incidental life insurance limit does not apply to premiums that are paid with contributions that have accumulated in the trust for at least two years in a profit sharing plan.

D. A participant's death benefit in a defined contribution plan will be the greater of the face value of the life insurance policy or the participant's vested account balance.

E. Insurance policies held in a participant's account may not continue to be held in the plan after the participant retires.

Question 49:
Which of the following statements regarding ARA's Code of Professional Conduct is/are TRUE?

I. An ARA member may perform professional services only when qualified to do so based on education, training and experience.
II. At a client's written direction, an ARA member may perform professional services that mislead, violate or evade the law.
III. An ARA member must disclose to a client all sources of compensation received for services provided to that client by the ARA member.

A. II only
B. III only
C. I and II only
D. I and III only
E. I, II and III

Question 50:
Which of the following requirements under the ARA Code of Professional Conduct is/are necessary in order for an ARA member to perform professional services involving an actual or potential conflict of interest?

I. There must be full disclosure to the client of any actual or potential conflicts of interest.

II. There must be full disclosure to the client of a significant conflict that may impair the member's ability to act fairly in that situation.

III. The member's client must expressly agree to the performance of the services by the member.

A. I only
B. III only
C. I and II only
D. II and III only
E. I, II and III

Question 51:
All of the following statements regarding ARA's Code of Professional Conduct are TRUE, EXCEPT:

A. An ARA member shall make use of the membership titles and credentials only where that use conforms to the practices authorized by ARA.

B. An ARA member shall render opinions or advice only when qualified to do so based on education, training or experience.

C. An ARA member shall make full and timely disclosure to a principal of all sources of compensation or other material consideration received with respect to services performed for such principal.

D. An ARA member may perform professional services involving a potential conflict of interest without the express written agreement by all principals.

E. An ARA member has an obligation to observe standards of professional conduct in the course of providing any services to a principal.

Question 52:
All of the following statements regarding ARA's Code of Professional Conduct are TRUE, EXCEPT:

A. An ARA member shall not perform any professional services involving a potential conflict of interest.

B. An ARA member shall perform professional services only when qualified to do so based on education, training or experience.

C. An ARA member shall perform professional services with honesty, integrity, skill, and care.

D. An ARA member shall make use of the membership titles and credentials only where the use conforms to the practice authorized by ARA.

E. An ARA member has an obligation to observe standards of professional conduct in the course of providing any service to a principal.

Question 53:
All of the following are ethical violations under the ARA Code of Professional Conduct, EXCEPT:

A. Disclosure of a participant's salary to another plan participant

B. Use of the QPA designation by a candidate who is awaiting confirmation that they have been awarded the designation

C. A third-party administrator hiding a significant conflict of interest between the plan and the interest of another party

D. A third-party administrator advertising that an enrolled actuary is on their staff, but utilizing the services of an outside actuary

E. Disclosure to the plan sponsor of fees paid to the third-party administrator by a broker that invests the plan assets

SHORT ANSWER KEY

Question	Answer	Question	Answer
1	D	28	C
2	B	29	D
3	D	30	E
4	C	31	B
5	B	32	B
6	D	33	C
7	A	34	E
8	A	35	D
9	A	36	D
10	C	37	C
11	A	38	A
12	A	39	C
13	E	40	E
14	D	41	B
15	E	42	A
16	E	43	B
17	C	44	E
18	E	45	D
19	E	46	E
20	B	47	A
21	E	48	D
22	C	49	D
23	C	50	E
24	C	51	D
25	C	52	A
26	E	53	E
27	C		

Long Answer Key

<table>
<tr><td>1.</td><td>D</td><td>In some situations, recipient employers have become participating employers in the leasing organization’s plan, creating a multiple employer plan in which the leasing organization and its clients (i.e., the recipients) participate in a single plan for administrative convenience.

As with all multiple employer plans, participating employers are treated as a single employer plan for certain purposes such as eligibility, the exclusive benefit rule, vesting, the IRS §415 limits, and Form 5500 filing.

A multiple employer plan does not require common ownership between the recipient and the leasing organization. (Syllabus Topic 2)</td></tr>
<tr><td>2.</td><td>B</td><td>For an individual to be treated as a leased employee under IRC §414(n), the following conditions must be met:
The leasing organization, not the recipient, must be the common law employer of the individual (Very Important);
Services must be provided by the individual under an agreement between the leasing organization and the recipient;
The individual must be providing services to the recipient on a substantially full-time basis for at least one year; and
The recipient must have primary direction or control over the individual’s services
Very Important (emphasized from above): A threshold requirement for treating an individual as a leased employee under IRC 414(n) is that the individual must be the common law employee of the leasing organization. (Syllabus Topic 1)</td></tr>
<tr><td>3.</td><td>D</td><td>For an individual to be treated as a leased employee under IRC §414(n), the following conditions must be met:
The leasing organization, not the recipient, must be the common law employer of the individual;
Services must be provided by the individual under an agreement between the leasing organization and the recipient;
The individual must be providing services to the recipient on a substantially full-time basis for at least one year; and
The recipient must have primary direction or control over the individual’s services.
(Syllabus Topic 1)</td></tr>
<tr><td>4.</td><td>C</td><td>For an individual to be treated as a leased employee under IRC §414(n), the following conditions must be met:
The leasing organization, not the recipient, mist be the common law employer of the individual;
Services must be provided by the individual under an agreement between the leasing organization and the recipient;
The individual must be providing services to the recipient on a substantially full-time basis for at least one year (i.e., 12 months); and
The recipient must have primary direction or control over the individual’s services.</td></tr>
</table>

		(Syllabus Topic 1)
5.	B	**Earned income** for a self-employed individual with common law employees is his/her **gross** Schedule C income (i.e., before any reduction for contributions for common law employees) reduced by (1) contributions for common law employees; (2) ½ of the self-employment tax (i.e., Social Security tax) less the self-employed individual's retirement plan contribution. In this question, the given gross Schedule C income of $180,000 is reduced by (1) $24,000 (i.e., contributions for employees), (2) $4,750 (i.e., ½ self-employment tax); and $10,000 (i.e., contributions for self-employed individual). The self-employed individual's earned income is $141,250 (i.e., $180,000 - $24,000 - $4,750 - $10,000) (Syllabus Topic 2)
6.	D	A **multiemployer plan** is one that is maintained pursuant to one or more collective bargaining agreements to which more than one employer is required to contribute. **These plans will always be individually designed plans because prototype and volume submitter plan (i.e., pre-approved plan) procedures do not accommodate multiemployer plans.** The IRC allows the participating employers in a multiemployer plan to be treated as a single-employer plan for certain purposes, listed below, even though these employers are not related: • Eligibility and coverage purposes • Nondiscrimination • Exclusive benefit rule • Vesting • Funding and deduction • IRC §415 limits; and • Form 5500 filing (Syllabus Topic 1)
7.	A	An S corporation is a corporation that has made an election to be taxed as a partnership. The S corporation is disregarded as an entity for tax purposes, and the net income of the corporation flows to the individuals who own stock in the corporation, called shareholder-employees. There are some strict limitations on whom or what can form an S corporation as follows: • S corporation may have no more than 100 shareholders; • None of the shareholders may be other entities or trusts (although there are many exceptions to the trust exclusion, including employee stock ownership plans (ESOPs) and certain IRAs that held stock in a banking corporation when it became an S corporation; • No nonresident aliens may be shareholders; and • S corporations may have only one class of stock. There are two types of income that may be earned by a shareholder-employee in an S corporation: 1. Salary: As with other corporations, shareholders may be employees of the S corporation and may be paid compensation as an employee, subject to W-2 reporting.

		2. Net profit: The allocation of the net profit of the S corporation to the shareholder-employee in his or her role as a shareholder. This allocation is similar to a dividend, although because the S corporation is a pass-through organization, the shareholder may not actually receive the income in cash; it simply flows to him or her when the S corporation is disregarded for tax purposes. (Syllabus Topic 2)
8.	A	If the requirements for QSLOB are met, an employer may elect to apply the coverage tests under IRC §410(b), and, as a result, the nondiscrimination tests of IRC §401(a)(4) separately to each QSLOB. In other words, the purpose of making a QSLOB election is to perform certain testing requirements on a QSLOB-basis rather than on an employer-wide basis. In order to perform the coverage (and thereby the nondiscrimination testing) separately, the plan must first satisfy the nondiscriminatory classification requirement of the coverage test under IRC §410(b) on an employer-wide basis. Even though the QSLOB rules apply for coverage and nondiscrimination, the separate lines of business are still treated as part of a single-employer for purposes of all other qualification rules, such as the crediting of service for eligibility purposes (IRC §410(a)) or vesting purposes (IRC §411), the contribution and benefit limits under IRC §415, and testing whether plans are top heavy under IRC §416. (Syllabus Topic 2)
9.	A	Summary of family attribution under the IRC §1563 controlled group attribution rules: • Attribution between spouses (unless exception applied); • Attribution from parent to minor child (under age 21); • Attribution from minor child to parent; • Attribution from adult child (21 or older) to parent only if parent owns (directly or by other attribution) more than 50% of the company**, and only the child's ownership *in that company* (i.e., company in which the parent owns more than 50%) is attributed to the parent;** • Attribution from parent to adult child only if adult child owns (directly or by other attribution) more than 50% of the company, and only the parent's ownership in that company is attributed to the adult child; • Attribution from grandchild (regardless of age) to grandparent only if grandparent owns (directly of by other attribution) more than 50% of the company, and only the grandchild's ownership in that company is attributed to the grandparent; • Attribution from grandparent to grandchild (regardless of age) only if grandchild owns (directly or by other attribution) more than 50% of the company, and only the grandparent's ownership in that company is attributed to the grandchild; and • No attribution between siblings (Syllabus Topic 3)
10.	C	The following is a summary of family attribution under IRC §1563 (relative to determining controlled group situations): (1) Attribution between spouses (unless exception applies: (2) Attribution from parent to minor child (under age 21); (3) Attribution from minor child to parent; (4) Attribution from adult child (age 21 or older) to parent only if parent owns (directly or by other attribution), more than 50% of the company, and only the child's ownership in **that** company is attributed to the parent; (5) Attribution from parent to adult child only if adult child owns (directly or by other attribution) more than 50% of the company, and only the parent's ownership in that

		company is attributed to the adult child; (6) Attribution from grandchild (regardless of age) to grandparent only if grandparent owns (directly or by other attribution) more than 50% of the company, and only the grandchild's ownership in that company is attributed to the grandparent; (7) Attribution from grandparent to grandchild (regardless of age) only if grandchild owns (directly or by other attribution) more than 50% of the company, and only the grandchild's ownership in that company is attributed to the adult grandchild; and finally note that there is no attribution between siblings. As can be seen from above, a father-in-law is not attributed ownership of a business held by his daughter in law. (Syllabus Topic 3)
11.	A	If two or more organizations are part of an ASG (Affiliated Service Group), the organizations are treated as a single-employer when applying certain employee benefit requirements. These requirements are as follows: – Eligibility and vesting – Coverage testing – Nondiscrimination – Annual addition limitations (under IRC §415(c)) – Top heavy rules – Compensation limit – Elective deferral limit/catch-up contributions – SEPs/SIMPLEs For purposes of this question, SEPs and SIMPLE-IRA plans must cover the employees **of all ASG (Affiliated Service Group)** members who satisfy the eligibility requirements of the SEP or SIMPLE-IRA, whichever applies. Note that the 100-employee limit under the SIMPLE-IRA rules is applied on an ASG basis. (Syllabus Topic 3)
12.	A	A parent-subsidiary controlled group exists when one business (the **common parent**) owns at least 80% of one or more businesses (the **subsidiaries**). A single-parent subsidiary group may be comprised of multiple subsidiaries owned by a common parent. A single parent-subsidiary also may consist of multiple tiers of subsidiaries that are at least 80% owned by a common parent or one or more subsidiaries in a higher tier within the controlled group structure. For purposes of applying the limitations under IRC §415, a parent-subsidiary relationship exists if the parent owns more than **50%** of the subsidiary. A brother-sister controlled group exists if five or fewer common owners satisfy **both** an 80% common control test **and** a 50% effective control test. A common owner may be an individual, a trust, or an estate. The businesses must satisfy **both** tests to constitute a brother-sister relationship. (Syllabus Topic 3)
13.	E	A **professional service corporation** for ASG purposes is a corporation organized for the principal purpose of providing professional services. Professional services mean services performed by accountants, actuaries, architects, attorneys, chiropodists, chiropractors, medical doctors, dentists, professional engineers,

		optometrists, osteopaths, podiatrists, psychologists and veterinarians. At least one shareholder of the corporation must be licensed or otherwise legally authorized to render the professional services. (Syllabus Topic 3)
14.	D	IRC §318 contains the attribution rules that are used for ASG purposes (IRC §318 attribution rules are also used in the determination of HCEs and key employees.). Under IRC §318, an individual is treated as owning any interest that is owned by the individual's spouse, children, grandchildren, or parents. Note, however, a grandparent's ownership interest is not attributed under IRC §318 to that individual's grandchild. Since K would be the grandchild, K's grandparent's ownership would not be attributed to K. (Syllabus Topic 3)
15.	E	A plan is required to use IRC §415 compensation to apply limits on allocations and benefits under IRC §415 within a **limitation year**. IRC §415 compensation is based on a **limitation year**, which may or may not be the same as the **plan year**. The use of IRC §415 compensation is also required to be used for: • Identifying HCEs; • Identifying key employees; • Calculating minimum benefits or contributions for non-key employees and/or key employees under top heavy plans; and • Determining certain minimum contributions (i.e., "gateway contributions) that must go to participants in plans that use "cross-testing" as a means of demonstrating nondiscrimination in favor of HCEs. (Syllabus Topic 4)
16.	E	IRC §414(s) defines that constitutes a nondiscriminatory definition of compensation. Each of the IRC §415 compensation definitions is a safe harbor definition of IRC §414(s) compensation. The regulations under IRC §414(s) permit three safe harbor modifications to the IRC §415 compensation in arriving at IRC §414(s) compensation. 1. Exclusion of fringe benefits and other special compensation items; 2. Treatment of elective deferrals in the opposite manner as they are treated under IRC § definition (in other words elective deferrals can be excluded for IRC §414(s) purposes); and 3. Exclusions applied only to HCEs. (Syllabus Topic 4)
17.	C	A short **taxable year** may affect the computation of the employer's deduction. **Note**, however, in this question we are told that the employer's **taxable year** is unchanged. It is only the employer's **plan year** that is less than 12-months long (i.e., a **short plan year).** In the case of a short **taxable year**, the IRC §404(a)(3) deduction limit (i.e., 25% of compensation limit) is applied to the aggregate participant compensation paid for the short period. In addition, the short **taxable year** will cause the applicable compensation dollar limit under IRC §401(a)(17) to be prorated. **Note**, however, in this question we are told that the employer's **taxable year** is unchanged. It is only the employer's **plan year** that is less than 12-months long (i.e., a **short plan year).**

		If the **taxable year** is changed resulting in a short **taxable year** but the **plan year** is not changed, the employer will need to designate for which **plan year** the contribution is made. Statement III is false because the compensation dollar limit is not affected since the **taxable year** did not change. (Syllabus Topic 4)
18.	E	To satisfy coverage testing under IRC 410(b), the plan must satisfy either the ratio test or the average benefits test. The plan may use **snapshot testing** to identify the employee population for coverage testing purposes. The employer would identify the coverage testing group and the benefiting group on the basis of the employee population on the snapshot testing date. A coverage test performed for a plan year can be relied on for up to two succeeding plan years if the employer reasonably concludes that there has not been any significant change affecting the outcome of the coverage test performed in that prior year. Relative to the average benefits test, there are two parts to the average benefits test. The first part is the nondiscriminatory classification test and the second part is the average benefit percentage test. **Both** of these parts of the test must be satisfied for the plan to pass the average benefits test. (Syllabus Topic 5)
19.	E	If the employer maintains more than one qualified plan, the plan actually being tested fo0r coverage under the average percentage test is not the only plan taken into account. The average benefit percentage testing group must be identified, and data from **all** plans of the employer (including all companies in the controlled group or affiliated service group) is used to calculate the employee benefit percentages. The benefit percentage for this participant is the (1) sum of the money purchase plan contribution (8.0%), (2) the money purchase plan forfeitures (1.5%), (3) the profit sharing plan contribution (5.8%), (4) the elective deferrals in the 401(k) plan (9.0%), and the matching contributions in the 401(k) plan (4.5%). Therefore, the benefit percentage is 28.8 % (i.e., 8.0% + 1.5% + 5.8% + 9.0% + 4.5% = 28.8%). (Syllabus Topic 5)
20.	B	In general, when determining the coverage testing group, the employees who have not satisfied the plan's age and service requirements are excluded. If the plan's age and service requirements are more liberal than the statutory requirements of age 21 and one year of service, the plan is covering employees it otherwise could exclude from the coverage testing group. These employees are known at *otherwise excludable employees.* The employer **is permitted** to disaggregate the portion of the plan covering the otherwise excludable employees from the rest of the employees (i.e., the *statutory employees)*. **All** coverage testing is done **separately** for the otherwise excludable employees (i.e., both NHCE and HCE otherwise excludable employees) and for the statutory employees as if they were in separate plans and were ineligible for permissive aggregation. Unlike the other disaggregation rules (except QSLOB testing), disaggregating otherwise excludable employees is elective. If an employer disaggregates otherwise excludable employees to run coverage for a plan year, it is not required to take the same approach in the next plan year. The decision to use otherwise excludable employees disaggregation is made on a year-by-year basis. The employer may choose to run coverage testing without disaggregating statutory employees and otherwise excludable employees and

		perform a single coverage test that takes into consideration both groups of employees. **Note:** The special testing option that permits disaggregation of otherwise excludable employees does not apply with reference to the two-year eligibility rule. For example, a profit sharing plan may not define otherwise excludable employees to mean employees who are eligible for the plan but would be excluded if the plan imposed a two-year eligibility requirement. (Syllabus Topic 5)
21.	E	All three statements are true. When an employer maintains two or more plans, it usually tests each plan separately for coverage purposes. As an alternative, the employer may aggregate one plan with the other plan and treat the two plans as a single plan for testing purposes. The aggregation of two or more plans to pass coverage is known as *permissive aggregation*, because the employer elects to use this testing option. Plans may **not** be permissively aggregated unless they have the same plan year. Only qualified plans under IRC §401(a) are eligible for permissive aggregation. An employer may **not** aggregate a qualified plan with a 403(b) plan or a SEP to demonstrate that the qualified plan passes the coverage test under IRC §410(b). Plans are not treated as permissively aggregated unless they are aggregated to perform the ratio percentage test or the nondiscriminatory classification test portion of the average benefit test. Permissive aggregation may be used when one of the employer's plans fails the ratio percentage test, but the employer does not want to rely on the average benefit percentage test to show coverage is satisfied. Permissive aggregation may also might be used when a plan is unable to pass the nondiscriminatory classification test portion of the average benefit test, but can pass if it is permissively aggregated with another plan maintained by the employer. **Note:** If the employer permissively aggregated two plans to pass the ratio percentage test or the nondiscriminatory classification test, it must also perform nondiscrimination testing for those plans on a combined basis. (Syllabus Topic 5)
22.	C	A controlled group situation can affect coverage testing. Due to mergers, acquisitions, dispositions or spin-offs of companies, the make-up of a controlled group or affiliated service group may change. It is difficult to deal with the coverage changes at the time of a company transaction of this sort. In recognition of the fact that this is a complex time for a company or group of affiliated companies, there is a safety valve in IRC §410(b)(6)(C). Under this safety valve, if a company satisfies coverage at the time of the acquisition or disposition of a related group member, the plan is deemed to meet coverage during a transition period after the transaction. **The transition period begins on the date of the transition and ends on the last day of the next plan year beginning after the transaction (subject to an earlier ending date in the event of certain changes in the plan).** One of the more problematic issues with respect to determining id the transition period applies is that there can be no significant change in coverage under the plan during the transition period, other than a change *directly* resulting from the acquisition or disposition. In regulations, the IRS interpreted this prohibition to

		include significant changes "in the plan or in the coverage of the plan." This would indicate that many, if not all, amendments to the plan during the transition period may affect the continuation of the transition period. The transition rule is optional. The plan sponsor may instead elect to apply the coverage tests during the transition period. (Syllabus Topic 5)
23.	C	Rate groups are identified by reference to the rate of each HCE. An HCE's rate group includes all employees (i.e., HCEs and NHCEs) who have a rate equal to or greater than the HCE's rate. In this example, there are three rate groups for general testing purposes (i.e., nondiscrimination under IRC §401(a)(4)): one for the two HCEs with a 5.25% benefit percentage (i.e., EBAR), one for the two HCEs with a 2.5% benefit percentage (i.e., EBAR), and one for the HCE with a 15.50% benefit percentage (i.e., EBAR). (Syllabus Topic 6) There are three different rates groups as you need one rate group for each HCE who is benefitting at a different rate.
24.	C	Benefits, rights, and features (BRFs) provided by the plan must be available on a nondiscriminatory basis. There are two availability tests that must be satisfied – a **current availability test** and an **effective availability test.** A plan must satisfy **both** availability tests to demonstrate that the BRFs are not discriminatory. **Benefits**, for purposes of the "availability" tests, are optional forms of benefit and ancillary benefits provided under the plan. An optional form of benefit is any distribution alternative provided by the plan with respect to the payment of benefits. **Ancillary benefits** are: (1) Social Security supplements, (2) disability benefits not in excess of the qualified disability benefit under IRC §411(a)(9), (3) ancillary life insurance and health benefits provided under the plan, (4) death benefits under a defined contribution plan, (5) preretirement death benefits under a defined benefit plan, (6) shut-down benefits that are not protected under IRC §411(d)(6) and (7) any other similar benefits. **Rights and features** are defined by example in the regulations, and include (1) participant loan provisions, (2) the right to direct investment, (3) the right to a particular form of investment (e.g., a class of employer securities), (4) the right to purchase additional ancillary benefits (e.g., life insurance coverage) and (5) the right to make rollovers and transfers to and from the plan. (Syllabus Topic 6)
25.	C	EBARs are determined by expressing the allocation of contributions and forfeitures in a defined contribution plan as an annual benefit payable as a single life annuity at the employee's testing age (similar to the way a defined benefit plan would express the normal form of benefit). This process is known as normalizing the benefit. The process of normalizing benefits is based on the principle of the time value of money, which recognizes that a younger participant has more years during which a contribution may grow into a meaningful benefit at retirement than an older participant. Therefore, a contribution for the benefit of a younger individual is more valuable that that same contribution made for the benefit of an older participant.

		Statement III in this question, which is false, describes an "allocation rate" and not an EBAR. (Syllabus Topic 6)
26.	E	Refer to DC-3 Text 7th Edition page 7-13 for a complete description of this calculation. EBARs are determined by expressing the allocation of contributions and forfeitures in a defined contribution as an annual benefit payable as a single life annuity at the employee's testing age. To make this determination: – Determine the participant's actuarial factor for the plan year based on his or her number of years to the plan year he or she reaches age 65. This actuarial factor is provided in the testing question. – Multiply the actuarial factor determined above by the participant's compensation. This is the normalization factor. The normalization factor represents the present value of an annual benefit equal to 1% of compensation payable at the testing age of 65. – Divide the allocation being normalized by the normalization factor. The result is the EBAR, expressed as a percentage, because it represents the number of multiples of 1% annual benefit. – In this problem the actuarial factor of .008784 is provided. Multiply this actuarial factor by the participant's compensation (i.e., $160,000 * .008784 = 1,405.44). The 1,405.44 is the normalization factor. Divide the allocation being normalized by the normalization factor (i.e., $40,000/1405.44 = 28.46). The result (i.e., 28.46) is represented as a percentage or 28.46%. This is the EBAR. (Syllabus Topic 6)
27.	C	Under the **gateway contribution test** (designated as the minimum allocation gateway in the regulations), the lowest permissible allocation rate for any NHCE who benefits under the plan is one-third of the highest allocation rate for any HCE who benefits under the plan. This is also referred to as the ***one-third test.*** **However**, if each NHCE receives an allocation that is no less than 5% of IRC §415 compensation (i.e., as defined under IRC §415(c)(3)), the gateway is deemed satisfied. This is also referred to as the ***5 percent test.*** HCE1 has an allocation rate of 12% ($12,000/$100,000) and HCE2 has an allocation rate of 6% ($6,000/$100,000). This would mean that to satisfy the gateway contribution test, the NHCE would need an allocation rate of 4% so that it is at least 1/3 of the highest HCE allocation rate. The minimum allocation necessary is $2,000 ($50,000 *4%). Note that satisfying the one-third test is less expensive than satisfying the 5 percent test. The question wants the minimum allocation necessary to satisfy the gateway contribution test. (Syllabus Topic 6)
28.	C	Mandatory disaggregation of plans generally refers to the required division of a plan into sections for testing purposes (e.g., ESOP and Non-ESOP portions; union and nonunion portions) Each disaggregated portion of a plan is treated as a separate plan for testing purposes. If a plan passes coverage without being aggregated with another plan maintained by the employer, the contributions or benefits under that plan are tested for nondiscrimination separately from any other plan the employer maintains.

		The law allows for the aggregation of two or more plan to pass coverage. This is known as permissive aggregation, because it is done at the election of the employer. If two or more plans are permissively aggregated for coverage testing, they must also be aggregated for nondiscrimination testing. Plans may be permissively aggregated only if they are maintained by the same employer (or members of the same related group of employers), and only if the plans have the same plan year. Restructuring is known as the permissive disaggregation of certain portions of a plan into component plans. A component plan consists of all the allocations, accruals, and other benefit, rights, and features provided to a selected group of employees. The groups can be identified in any manner the employer chooses, and the composition of the groups may change from year to year, provided that each component plan could satisfy coverage if the component plan were a separate plan. No special language is needed to restructure the plan into component plans for testing purposes. **The nondesign-based safe harbor for uniform points plans is not an available testing method for a component plan.** Only general testing may be used for this type of plan. (Syllabus Topic 6)
29.	D	The IRC §401(a)(4) nondiscrimination regulations coordinate closely with the coverage rules because coverage testing is simply a requirement to cover a nondiscriminatory group of employees in the plan. Therefore, the “plan” for coverage testing is the same as the “plan” for IRC §401(a)(4) nondiscrimination testing. This means that, if the plan passes coverage without being aggregated with another plan maintained by the employer, the contributions or benefits under that plan are tested for nondiscrimination separately from any other plan the employer maintains. The coverage regulations provide various testing methods for showing coverage compliance, such as the annual testing method and the quarterly testing method. Whatever method is used to test coverage must also be used to test nondiscrimination under IRC §401(a)(4). A **design-based safe harbor** allocation method is deemed to provide nondiscriminatory contributions. There is no “general testing” required or applicable. This is because the allocation formula is designed to produce uniform allocation rates, or rates that are deemed to be uniform. (Syllabus Topic 6)
30.	E	All if the Statements are true. A **stock bonus plan,** like a profit sharing plan, is a nonpension plan. However, in a stock bonus plan, the benefits are distributable in employer stock. A stock bonus plan has the same contribution and allocation formula options as a profit sharing plan. Most of these plans provide for a discretionary contribution formula and may adopt any of the allocation formulas available for profit sharing plans. The employer may make its contribution in the form of its own stock. If the employer makes cash contributions, the fiduciaries usually invest those contributions exclusively or primarily in employer stock. Stock bonus plans are subject to some of the rules applicable to ESOPs. These include the right to demand stock distributions and the put option obligation. (Syllabus Topic 7)

31.	B	An entire plan or just a portion of a plan may be designated as an ESOP. If only a portion of a plan is designated as an ESOP, the other portion of the plan will be characterized as one of the other types of defined contribution plans. The ESOP (or ESOP portion of a plan) must be designed to invest **primarily** in employer securities. The contribution and allocation formulas under an ESOP normally operate under the same rules as for profit sharing plans. However, a permitted disparity allocation formula may **not** be used with an ESOP (or under an ESOP portion of a plan). **An ESOP may include a 401(k) elective deferral feature. This is commonly referred to as a KSOP.** A plan sponsor of an ESOP may contribute **either** stock or cash to the plan. This is a feature unique to ESOPs and stock bonus plans. The purchase of employer stock by the plan from another shareholder or from the plan sponsor normally would be a prohibited transactions (i.e., PT). The statute provides an exemption from the PT rules if the following requirements are met: (1) the purchase of the securities by the plan may not be for more than adequate consideration; (2) the plan may pay no commissions on the sale; and (3) the amount of stock owned by the plan may not exceed any legal limits on the ownership of employer securities. **Note:** These limits generally do not apply to ESOPs, which are designed to invest primarily in employer securities. A significant distinguishing factor of an ESOP is its ability to borrow, either from the employer or from a third party, with the employer's guarantee to purchase stock. If an ESOP is *leveraged*, special rules apply to the lending transaction. In addition, the character of the plan changes significantly as other special rules come into play. One of the crucial differences between leveraged and nonleveraged ESOPs is the deduction limit. The deduction limit for ESOPs and stock bonus plans is equal to 25% of eligible compensation. However, a special limit applies for a *leveraged* ESOP. This limit permits the deduction of up to 25% of eligible compensation for principal payments on the loan. In addition. A leveraged ESOP may deduct any amount contributed to pay loan interest. The 25% limitation for the *leveraged* ESOP does not take into account contributions to other defined contribution plans maintained by the employer. Those contributions are subject to the normal 25% limit, which is entirely separate. **Note:** This additional 25% deduction for ESOPs is only allowed if the employer is a C corporation. (Syllabus Topic 7)
32.	B	Diversification is available in an ESOP for a plan year to a "qualified participant" (i.e., a participant who is at least age 55 and has ten years of participation at the end of the plan year). A qualified participant must be permitted to diversify up to 25% of the portion of his or her account balance that is invested in employer stock. The diversification period continues for a total of five years at the 25% level. In the sixth year, the participant must be allowed to diversify up to 50% of his or her account balance. The amount available for diversification each year during the election period is reduced by the amount that has already been diversified. In this question, at age 58 with 25 years of participation, Participant A is eligible to diversify up to 25% of the shares less the amount that has already been diversified. (i.e., 20,000 current shares plus 4,000 shares previously diversified = 24,000 total shares.)

		(24,000 * 25%) – 4,000 shares already diversified = 2,000 shares currently available for diversification. (Syllabus Topic 7)
33.	C	A significant distinguishing factor of an ESOP is its ability to borrow, either from the employer or from a third party, with the employer's guarantee, to purchase stock. **When an ESOP borrows to purchase stock, the only security for the loan is the stock that is purchased with its proceeds. The lender may not have any further recourse against the plan or its participants.** As a result, most third-party lenders require that the *employer* guarantee the loan on behalf of the ESOP. This guarantee would normally be a prohibited transaction, but Treasury and ERISA regulations provide a special exemption for ESOPs. The shares purchased by an ESOP act as security for the loan that the ESOP obtains for the purchase. At the time the loan is taken, all of the shares purchased with the loan proceeds are encumbered, acting as security for the loan. Encumbered shares are not allocated to participants' accounts but are held in suspense until the encumbrance is released. As principal payments are made on the loan, some of the shares are released from encumbrance. At that time, they are allocated to the participants' accounts. The ESOP loan must be for the primary benefit of the participants and beneficiaries, even though the employer also receives incidental benefits from the transaction (e.g., cash obtained from the plan's purchase of employer securities). Earnings on the collateral for an ESOP exempt loan (i.e., the shares held in suspense) may be used to make repayments on that loan. If the ESOP is leveraged, the ESOP may be permitted to delay distributions of securities to the participants until the loan is completely repaid. This permits the plan to avoid having the lender and the participants compete for available cash reserves while the loan is outstanding. (Syllabus Topic 7)
34.	E	The IRC was amended in 1998 to permit S corporations to sponsor ESOPs. Generally, the rules for *S corporation ESOPs* are the same as for those sponsored by C corporations, with these few exceptions: (1) First and foremost, because an S corporation is a pass-through entity for tax purposes, there are no taxed paid at the corporate level. The shareholders are credited with the income, losses, and deductions of the S corporation. To the extent that the ESOP is a shareholder of an S corporation, the ESOP's portion of any income will be paid to a tax exempt entity. Therefore, that portion will not be subject to any taxation; (2) An s corporation ESOP may not provide for deductible dividends. Furthermore, because of the limitations on the number of shareholders in an S corporation, ESOPs sponsored by these entities do not have to – and generally do not – permit distributions in stock. Because stock distributions are not permitted, there is no need to provide put options in an S corporation ESOP. If, however, the S corporation does permit distributions of its stock to the participants, the application of special basis recovery rules for S corporations may limit the ability to defer the tax on net unrealized appreciation on those distributions, as there are in such distributions from a non-S corporation plan; and (3) owners of S corporation stock may not take advantage of the tax deferral on sales of stock to an ESOP under IRC §1042. S corporations may not take advantage of the expanded deduction and allocation limits under IRC §§404 and 415 that are provided to leverage ESOPs sponsored by C corporations.

		An ESOP has the ability to borrow, either from the employer or from a third party with the employer's guarantee, to purchase stock. An ESOP that does this is called a **leveraged ESOP.** This option is available to both a C corporation and an S corporation ESOP. (Syllabus Topic 7)
35.	D	Under an IRC §1042 transaction, if the sponsoring company is a C Corporation, an owner or owners of more than 30% of the stock who sell that stock to the ESOP and reinvest the proceeds in equity or debt instruments of other unrelated U.S. companies, may defer recognition of the gain until the reinvested assets (called **qualified replacement property)** are sold. This favorable tax treatment can be very valuable to a closely held business when he or she wants to divest. The following requirements must be met in a §1042 transaction: (1) the seller must have owned the stock sold to the ESOP for at least three years, (2) the ESOP must own at least 30% of the employer's stock after the sale, (3) the proceeds from the sale of the securities to the ESOP must be reinvested in qualified replacement property, (4) qualified replacement property must be purchased within a period that begins three months *before* the date of the sale of the employer securities to the ESOP and ends 12 months *after* such date, (5) a statement of purchase must be prepared, notarized and then filed with the seller's tax return, and (6) the seller, member of the seller's family and other more than 25% shareholders cannot receive allocated shares acquired in the transaction during the nonallocation period. (Syllabus Topic 7)
36.	D	If the stock in an ESOP is publicly traded, the participant has a ready market for the distributed shares whenever he or she wants to sell them. If the stock is not publicly traded, the law provides for a mandatory put option from the participant to the company. A put option permits the holder of stock to demand that another person buy the stock at a given price. In the case of an ESOP, the put option permits a participant to present stock to the company and demand that the company buy back the stock at the then current fair market value. Generally, ESOP participants have the right to demand that their entire account be distributed in the form of employer securities. In certain circumstances, an ESOP is **not** required to distribute stock and may pay participants the equivalent value of their accounts in cash., In particular, if the articles of incorporation or bylaws for the company limit stock ownership to the ESOP and employees of the company, the ESOP does not need to (and, if the distribute is no longer employed by the company, cannot) distribute stock. A second situation in which stock distributions need not be permitted is when the plan sponsor is an S corporation. A participant in an ESOP must have the right to elect a distribution within one year after the close of the plan year in which he or she separates from service by reason of attainment of normal retirement age, disability or death. For separations due to other reasons, the participant must have the right to elect a distribution within one year after the fifth year following his or her separation. If the ESOP is leveraged, the ESOP may be permitted to delay distributions of securities to the participants until the loan is completely repaid. (Syllabus Topic 7)
37.	C	ERISA §3(21) defines a fiduciary as someone who is in at least of the following categories: (1) Exercising discretionary authority or discretionary control of the

		management of the ***plan***; (2) Possessing discretionary authority or discretionary control over the administration of the ***plan***; (3) Exercising any authority or control over the assets of the ***plan***; or (4) Rendering investment advice for a fee (or has any authority or responsibility to do so). Exercising discretionary control over the decision to make contributions to the plan, based on company profitability does **not** result in a person being considered a fiduciary. Exercising discretionary control over the decision to make contributions to the plan based on company profitability is a "settlor" function (i.e., employer function) and not a "fiduciary" function. (Syllabus Topic 8)
38.	A	A fiduciary is personally responsible for any breach of responsibility that he or she directly commits, either by act or omission. The fiduciary must restore losses incurred by the plan because of a breach. The obvious losses are those due to imprudent investing or failure to diversify investments as required by ERISA. The fiduciary may be required to pay to the plan any profits he or she earned through the use of plan assets in a breach. A court may award other equitable or remedial relief as it determines is appropriate to compensate the plan for the effects of the breach. Under certain circumstances, a plan may offset damages against a fiduciary-participant's benefit under the plan in which the breach occurred. A fiduciary is liable for another fiduciary's breach under certain circumstances. If a fiduciary knowingly participates in or knowingly conceals and act or omission of another fiduciary, knowing that the act or omission is a breach, the fiduciary may be held liable for such breach. If the fiduciary has enabled another fiduciary to commit a breach, the fiduciary may be held liable for that breach. If the fiduciary has knowledge of a breach by another fiduciary and does not make reasonable efforts under the circumstances to remedy the breach, the fiduciary may be liable for that breach. Reasonable efforts might include notifying other plan fiduciaries or the DOL. **If the fiduciary with knowledge of a breach is a trustee, mere resignation as a trustee may not be enough to avoid co-fiduciary liability.** Fiduciary liability, resulting from a participant's investment direction of the assets allocated to his or her account, can be significantly limited by complying with the requirements of ERISA §404(c). (Syllabus Topic 8)
39.	C	A fiduciary must carry out his or her duties solely in the interest of plan participants and beneficiaries. The fiduciary standards include: (1) the **exclusive benefit rule**, which requires the fiduciary to carry out his or her duties solely for the purpose of providing benefits to participants and their beneficiaries, except to the extent that assets are expended *for reasonable expenses* relating to the plan's operation and administration; (2) the **prudence standard,** which requires the fiduciary to discharge his or her duties in the manner of a prudent person with the care, skill, prudence and diligence of a person acting in a like capacity and familiar with such matters; (3) the **diversification standard**, which requires that investments must be diversified so as

		to minimize the risk of large losses unless, under the circumstances, it is clearly prudent not to do so; and (4) **compliance with the plan documents.** There is no requirement that a fiduciary must meet market rates of return within an acceptable range of like funds. (Syllabus Topic 8)
40.	E	All three statements are true. If a party-in-interest or a disqualified person enters into a prohibited transaction, he/she is required to reverse the transaction in such a way as to put the plan back into the condition it would have been in if the transaction had not taken place. Furthermore, the party-in-interest of disqualified person is subject to excise taxation by the IRS. Finally, a fiduciary that permits the plan to enter into a prohibited transaction may be considered to have breached his/her fiduciary duties. The calculation of the excises taxes due as a result of the prohibited transaction depends on the length of the taxable period and whether the transaction has been corrected. Any excise tax due is transmitted with Form 5330. The disqualified person is liable for the tax. Form 5330 is due by the last day of the 7th month following the *disqualified person's* taxable year for which the tax is being paid. An extension of up to 2 ½ months can be obtained by filing Form 5558. The extension does **not** extend the time for paying the excise tax, so interest is charged if the tax is paid after the regular due date. The initial tax is 15%, multiplied by the amount involved for each year (or part of a year) that is included in the taxable period. The year used here is the tax year of the disqualified person. If the prohibited transaction is not corrected, the IRS may impose a second tier tax which equals 100% of the amount involved if the prohibited transaction is not corrected within a certain time period after notification by the IRS. (Syllabus Topic 9)
41.	B	See the explanation for question #40 above. IRC §401(a), which lists the requirements for qualification under the IRC, does not refer to the prohibited transaction rules as one of its requirements. Therefore, a plan that engages in a prohibited transaction does not become a disqualified plan solely by reason of the transaction. The prohibited transaction rules are enforced through the excise tax provisions of IRC §4975. The prohibited transaction rules **DO** apply to participant-directed investments. In fact, DOL Reg. §2550.404c-1(e)(3) provides that nothing in ERISA §404(c) offers relief from the applicable excise taxes under IRC §4975 with respect to prohibited transactions engaged in by the participant-directed account. (Syllabus Topic 9)
42.	A	There are several statutory exemptions and class exemptions from the prohibited transaction (PT) rule. • An employer **may** contribute its own securities (i.e., qualifying employer securities) to the plan, or a plan may acquire employer securities from a disqualified person, without engaging in a PT, so long as the requirements of ERISA §408(e) are satisfied. ERISA contains exemptions for the sale of

		qualifying employer securities to or from the plan, and the leasing of qualifying employer real property by the plan. • Individual life insurance or annuity contracts may be purchased by the plan from the participant or employer. • The plan may sell a life insurance policy or individual annuity contract to the participant insured by the policy, to a relative of the insured participant, to the employer or to another employee benefit plan. This particular exemption is not available unless the plan is going to surrender the policy if it is not purchased under the exemption. • An ESOP may borrow money for the purpose of acquiring employer securities. The employer may make the loan to the ESOP, or the employer may guarantee a loan to the ESOP from a third party lender. • Reasonable compensation may be paid for office space or legal, accounting or other services “necessary for the establishment or operation of the plan. It is through this exemption that a service provider (e.g., third party recordkeeper) may receive payment for services directly from plan assets. • Loans to plan participants and beneficiaries are not PTs if certain conditions of IRC §4975(d)(A) and ERISA §408(b)(1) are satisfied. • There is **not** an exemption to the prohibited transaction rules that would allow a purchase **by the plan** of an office building for the plan sponsor’s business. (Syllabus Topic 9)
43.	B	The plan may not sell, exchange or lease property to a disqualified person, nor may a disqualified person sell, exchange or lease property the plan. This includes direct or indirect transactions. A sale, exchange or lease between a plan and a disqualified person is a prohibited transaction, even if the sale if for fair market value or the lease is for fair rental value. The Supreme Court has rules that a contribution of property (rather than cash) to satisfy a funding obligation is treated as a sale of property to the plan and is a prohibited transaction. The DOL issued additional guidance on this decision that provide that all contributions of property to a plan that is subject to minimum funding standards (e.g., money purchase pension, target benefit or defined benefit plans) are prohibited transactions. In a nonpension plan (e.g., profit sharing or stock bonus), the contribution of property is **not** a prohibited transaction if the contribution is purely discretionary and the property is unencumbered (i.e., it is not security for a loan). An employer may contribute its own securities (i.e., qualifying employer securities) to the plan, or a plan may acquire employer securities from a disqualified person, without engaging in a prohibited transaction, as long as the requirements of ERISA §408(e) are satisfied. Therefore, It is **NOT** a prohibited transaction for a company to contribute securities to a profit sharing plan as the annual contribution.

		A plan may not lend money or otherwise extend credit to a disqualified person (e.g., the employer), nor may a disqualified person loan money or otherwise extend credit to the plan. A loan between the plan and a disqualified person is a prohibited transaction, even if the loan is for fair market value. An indirect loan transaction arises when an employer is delinquent in transmitting participant contributions (including pre-tax elective deferrals, catch-up contributions and designated Roth contributions) under a 401(k) arrangement, after-tax employee contributions, and participant loan payments deducted from the participant's payroll. (Syllabus Topic 9)
44.	E	All statements are true. If the **covered service provider** fails to make the required disclosures as required under ERISA §408(b)(2), the prohibited transaction exemptions under ERISA §408(b)(2) will not apply, and the provision of services and charging of fees will be a prohibited transaction. At the least, the service provider will be liable for a 15% excise tax on the amount of fees charged. It is also in the IRS's enforcement powers to require that the prohibited transaction be "reversed" – that is, to have the service provider return to the plan any fees that have been paid. The plan fiduciary that engaged in the contract (referred to as the "responsible plan fiduciary) can be liable for a breach (Syllabus Topic 9)
45.	D	The required fee disclosures under ERISA §408(b)(2) must be made by anyone who is a **covered service provider (CSP).** A covered service provider is someone who enters into a contract or arrangement with a plan and reasonably expects to receive $1,000 or more in direct or indirect compensation for providing services to the plan. There are three categories of covered service providers: (1) fiduciaries or their affiliates); (2) platform providers for participant-directed DC plans (or their affiliates); and (3) indirectly compensated service providers (or their affiliates). Note that the required fee disclosures by covered service providers **only apply in situations where the fees are being paid by the plan.** These disclosure requirements do **not** apply if the plan sponsor (and not the plan) are paying the fees. ERISA is only interested in protecting plan assets (e.g., only paying reasonable fees from plan assets). ERISA is not interested is ensuring that the plan sponsor is paying reasonable fees from its checkbook. Plan sponsors can decide for themselves that the fees **they** are paying to a service provider are reasonable. (Syllabus Topic 9)
46.	E	A **party-in-interest** is defined in ERISA §3(14) (i.e., Title I of ERISA – the Labor provisions) for purposes of applying the prohibited transaction rules. ERISA §404(c) (i.e., Title I of ERISA – the Labor provisions) explicitly state that a participant who directs his or her investments in a participant-directed defined contribution plan is **not** a fiduciary for ERISA Title I purposes and hence is not a party-in-interest. (Syllabus Topic 9)
47.	A	Before a distribution can be made, the following must be provided to the participant: (1) written notice that explains the optional forms of payment available under the plan and if the QJSA rules apply a description of the QJSA, the participant's right to

		waive the QJSA and the relative values of the optional forms of benefit, (2) notice of the participant's right to delay payment until normal retirement age, and (3) information about the direct rollover option and information on other tax issues. There is no requirement that a plan provide a copy of the plan's administrative policy regarding the timing of distributions (even if there were such a document). (Syllabus Topic 10)
48.	D	Life insurance purchased for a participant in a qualified defined contribution plan generally must be an **incidental life insurance benefit**, which is incidental to the plan's primary purpose of providing retirement benefits. Life insurance in a defined contribution plan is incidental if the cumulative premium cost for the life insurance does not exceed a certain percentage of the aggregate contributions allocated to the participant. This is known as the **percent-of-contributions rule**. In general, the insurance is incidental if the cumulative premium cost for term insurance does not exceed 25% of the aggregate contributions. In applying the 25% limit, the entire premium cost of term insurance plus one-half of the premium cost of whole life insurance is taken into account. IRS treats universal life insurance as term insurance for purposes of the 25% limit. If the insurance is all whole life, the insurance is incidental if the total premium cost for the whole life policy is less than 50% of the aggregate contributions. For purposes of the percent-pf contributions rule, the aggregate contributions include employer contributions and forfeitures that are allocated to the participant's account, *but not earnings on those amounts.* Elective deferrals under a 401(k) plan are employer contributions for purpose of these limitations. If a profit sharing plan purchases life insurance only with **seasoned contributions**, the incidental life insurance limit does **not** apply. Contributions are seasoned if they have been accumulated in the trust for at least two years. The rule is based on the principle that, after profit sharing plan contributions have accumulated for two years, it is permissible for the plan to permit distribution of this amounts. A plan may provide for the purchase of life insurance with after-tax employee contributions. The incidental life insurance limitations do not apply to insurance protection purchased with after-tax employee contributions. For life insurance to be incidental, the policy must be converted to retirement income or distributed to the participant no later than the normal retirement date under the plan. **For purposes of this question:** A participant's death benefit in a defined contribution plan will be the **SUM** of the face value of the life insurance policy **AND** the participant's vested account balance. (Syllabus Topic 10)
49.	D	An ASPPA member may **not** perform professional services when the member has reason to believe that they may be used to mislead or to violate or evade the law. (Syllabus Topic 11)
50.	E	All three statements are true.

		The ASPPA Code of Conduct provides that a Member shall not perform Professional Services involving an actual conflict of interest **unless**: (1) the Member's ability to act fairly is unimpaired; and (2) there has been full disclosure of the conflict to the Principal(s); and (3) all Principals have expressly agreed to the performance of the services by the Member. (Syllabus Topic 11)
51.	D	The ASPPA Code of Conduct provides that a Member shall not perform Professional Services involving an actual conflict of interest **unless**: (1) the Member's ability to act fairly is unimpaired; and (2) there has been full disclosure of the conflict to the Principal(s); and (3) all Principals have expressly agreed to the performance of the services by the Member. (Syllabus Topic 11)
52.	A	The ASPPA Code of Conduct provides that a Member shall not perform Professional Services involving an actual conflict of interest **unless**: (1) the Member's ability to act fairly is unimpaired; and (2) there has been full disclosure of the conflict to the Principal(s); and (3) all Principals have expressly agreed to the performance of the services by the Member. (Syllabus Topic 11)
53.	E	An ASPPA member is not to disclosure to another party any confidential information obtained in rendering professional services for a Principal unless authorized to do so by the Principal or required to do so by law. An ASPPA member is to make truthful use of the membership titles and credentials of ASPPA to which the member is entitled. An ASPPA member is not to perform professional services involving an actual conflict of interest unless: (1) the member's ability to act fairly is unimpaired; (2) there has been full disclosure of the conflict to the Principal(s); and (3) all Principals have expressly agreed to the performance of the services by the member. An ASPPA member is not to engage in any advertising with respect to professional services that the member knows or is reasonably expected to know are false. **Note:** Disclosure to the plan sponsor of fees paid to the third-party administrator by a broker that invests the plan assets is not a violation of the ASPPA Code of Professional Conduct. In fact, this disclosure is required under the Form 5500 Schedule C requirements. (Syllabus Topic 11)