RETIREMENT PLANNING

Topics 59–67

JOHN AND BRIANNA HARRISON

PERSONAL INFORMATION AND BACKGROUND

John and Brianna Harrison, both age 44, have been married for seventeen years. They have twins, a boy and a girl, John, Jr. and Ariana, who are fifteen and are sophomores in high school. They have asked for help with their retirement planning and want to plan for 30 years of retirement, given the history of longevity in the family. Both of John's grandparents lived into their 90s.

Brianna's 40-year-old sister Esther is temporarily living with the Harrisons, along with her two children. She has just gone through a divorce and is trying to get her finances in order. She is looking for advice about taking a distribution from her IRA and also for a QDRO that will be paid to her.

EDUCATION INFORMATION

For college savings, the Harrisons have contributed to Coverdell ESAs. Each child has an account balance of $5,100, growing at 7% a year. They also opened Section 529 plans for the twins, and each child has a current account balance of $25,000. The Harrisons expect to continue funding the 529 plans up to age 18, with contributions of $12,000 to each account and growth at 6%. If they must take loans from a retirement plan, they do not want to do so in the first three years of the twins' college years due to continuing funding needs in addition to required payments on the loans. The Harrisons have also discussed cutting their contributions to their retirement plans, if needed, in order to fund the college costs. They could also consider refinancing their home or getting a home equity loan.

The Harrisons have discussed colleges with current tuitions of approximately $45,000 a year with increases averaging 6% a year. Further, the Harrisons have decided that they will use all of the Coverdell ESA money in the first year, plus approximately $15,000 from the 529 plan. The remaining funds for tuition plus room and board will be from other sources addressed at the time.

RETIREMENT INFORMATION

The Harrisons want to retire at their full retirement age for Social Security when they will need 80% of their current combined incomes (adjusted for inflation), minus $22,000 *each* (in today's dollars) that they anticipate from Social Security. Their major assumptions are: inflation of 4%, preretirement investment returns of 6%, and postretirement investment returns of 5%. They want to retain their primary residence during the entire planning horizon.

John's Retirement Benefits

John became the museum director of a large not-for-profit natural history museum five years ago. He now earns $250,000 and participates in the museum's Section 403(b) tax-sheltered annuity with pretax contributions only. The museum makes a contribution to the plan. In addition, he is covered by a SERP (supplemental executive retirement plan), a plan the museum used for his recruitment. The SERP plan is unfunded.

Brianna's Retirement Benefits

Brianna worked for a start-up technology company for seven years. When she left that company, she rolled her qualified plan into her IRA and bought U.S. Treasuries and some corporate bonds. Brianna left the company shortly before the twins were born and stayed home for three years. When the twins entered nursery school,

she returned to work and joined a research firm, Taylor, Jordan, and Reese, Inc. (TJ&R) where she now earns $200,000 a year.

TJ&R is a closely held company which has a defined-benefit program, as well as an ESOP. Brianna is concerned about diversification alternatives inside the ESOP due to recent fluctuations in the company's earnings.

The defined-benefit pension, funded mostly with mutual funds, is based on a formula of 2% per year of service times the average of the highest three years salary of the final five years, with a maximum of 25 years of service. Normal retirement age in the plan is age 65. If Brianna resigns from TJ&R, there is a lump-sum distribution available if she has been employed more than ten years.

Her employer has recently talked of terminating or amending the defined-benefit plan and installing a 401(k) plan. The 401(k) plan would probably be top-heavy. The company would use two years of service for eligibility due to rapid turnover of employees in the first two years of employment. The 401(k) plan may be added as a choice in the cafeteria plan.

BUSINESS INFORMATION

Brianna will consider leaving TJ&R at age 50. The twins will be close to completing their undergraduate years, and Brianna will be looking for new challenges. She wants to start a software company that supplies programs to her former employer, as well as to other companies. Initially, she will pay herself a small salary while she establishes the business. When the company becomes successful and cash flow has stabilized, she wants to set up a qualified plan to help achieve business as well as personal objectives but wishes the plan to maximize benefits to herself, while minimizing costs. Her long-term business plan envisions 25 employees, with 5 of them being key employees. The other likely demographics are: two of her key employees will be between 40 and 45; all of the other employees, including the other key employees, will be under age 40; her salary will be $230,000.

HEALTH CARE INFORMATION

They have made a start towards savings for health care with a new Health Savings Account (HSA), and they know they will have Medicare coverage. They plan on signing up for both Parts A and B as soon as they are eligible. They are concerned about long-term care expenses.

ESTATE PLANNING INFORMATION

John and Brianna executed simple wills, leaving everything to the surviving spouse, with the twins as the contingent beneficiaries about 10 years ago. They also executed springing durable powers of attorney and living wills at the same time.

John and Brianna Harrison
Statement of Financial Position
12/31 of Last Year

Assets		Liabilities	
Checking: JT	$ 8,000	Credit cards	$ 4,000
Money market funds: JT	7,000	Car loans	18,000
Bond funds: JT	40,000	Mortgage[1]	350,000
Mutual funds: JT			
U. S. equity	250,000		
Small-cap	30,000		
Mid-cap	70,000		
John: 403(b)[2]	63,000		
Brianna: DB plan[3]	76,000		
Brianna: ESOP[4]	112,000		
John: IRA[5]	15,000		
Brianna: IRA[6]	910,000		
Residence: JT	450,000		
Personal property: JT	100,000		
Automobiles: JT[7]	50,000		
Cash value of life insurance: H	50,000		
Cash value of life insurance: W	23,000		
TOTAL ASSETS	$2,254,000	LIABILITIES	$372,000
NET WORTH	**$1,882,000**		

H = Husband
W = Wife
JT = Joint tenancy with right of survivorship

[1]Original loan term for 30 years at 8%.
[2]Brianna is the primary beneficiary, and the twins are the contingent beneficiaries.
[3]John is the primary beneficiary, and the twins are contingent beneficiaries.
[4]Brianna is the only beneficiary.
[5]Brianna is the only beneficiary.
[6]John is the primary beneficiary, and the twins are contingent beneficiaries.
[7]John's $35,000 BMW and Brianna's $15,000 minivan

John and Brianna Harrison
Cash Flow Statement
for the Period 1/1 through 12/31
Annualized Projection

INFLOWS

John: Salary	$250,000
Brianna: Salary	200,000
Interest income	Reinvested
Dividend income	Reinvested
Capital gains	Reinvested
TOTAL INFLOW	**$450,000**

OUTFLOWS

Mortgage payment (P & I)	$ 42,000
Real estate taxes	5,000
Homeowners insurance	1,500
Federal income tax	90,000
State income tax	20,000
FICA and state payroll taxes	22,000
Life insurance premiums	5,200
Disability insurance premiums	3,400
Automobile insurance premiums	3,900
John's 403(b)	14,000
Food	7,500
Utilities	5,000
Telephone	1,200
Laundry	600
Clothing	8,000
Car expense	3,600
Car repairs	2,700
Home repair/maintenance	4,900
Charitable gifts	45,000
Entertainment	5,000
Vacations	10,000
Support/Dependents	13,000
529 plan contributions	24,000
Health Savings Account contributions	5,000
Savings/Investments	75,000
Unknown	32,500
TOTAL OUTFLOW	**$450,000**

Topic 59

Multiple Choice Questions

1. Which of the following assumptions have the Harrisons made in connection with their retirement planning?

   A. Long-term inflation rate of 3%
   B. Real rate of return in retirement of 2%
   C. Combined life expectancy of 30 years in retirement
   D. Income goal of 60% of current income

2. Which of the following represents the Harrisons' approach to estimating financial needs in retirement?

   A. Specific line-item cash flow projections
   B. Percentage guideline
   C. Reliance on a multiple of Social Security benefit projections
   D. Current income, less education funding, less debt service, plus travel expenses, adjusted for inflation

3. In terms of funding retirement needs, which of the following indicates the Harrisons' plans?

   A. Dependence on Brianna's full defined-benefit plan at normal retirement age
   B. A conservative preretirement real rate of return assumption of less than 2%
   C. Reliance on excess educational funding as a resource for their own retirement
   D. Cash flow from Esther for boarding expenses

4. Which of the following is the most viable option now, in the event of a projected retirement income shortfall?

   A. Stopping the 529 plan contributions for the twins
   B. Contributing to traditional deductible IRAs for both John and Brianna
   C. Contributing to Roth IRAs for both John and Brianna
   D. Reallocating Brianna's IRA to 70% equities and 30% fixed-income

5. Based on the Harrisons' salaries today, what will the Harrisons need as an annual payment from their retirement savings when they retire at full retirement age?

   A. $471,425
   B. $489,731
   C. $720,090
   D. $778,850

Topic 60

Multiple Choice Questions

1. Assume that John dies in six years. What Social Security benefits would be available?

   A. Brianna would receive 100% of John's PIA, and each of the children would receive 50% of John's PIA, subject to a family maximum.
   B. There would be no survivor benefits paid to Brianna for at least ten years, and John Jr. and Ariana would be too old for the survivorship benefit for minor children of a decedent.
   C. Brianna would receive 75% of John's PIA, and each of the children would receive 75% of John's PIA, as long as they remained full-time students.
   D. Brianna would receive no survivor benefits until she reached age 60, but the children would receive 75% of John's PIA, subject to a family maximum.

2. Which of the following is correct regarding the calculation of Brianna's Social Security retirement benefits?

   A. Based on her objectives, she will likely suffer a reduction in benefits for early retirement.
   B. Her total years in the work force will eliminate any reduction in benefits because of time she took off while the twins were infants.
   C. Due to the timing of the receipt of her benefits, she will experience a reduction as a result of excess earned income.
   D. Her benefits will be lower due to receiving a percentage of John's benefits at the same time.

3. If John decides to shift to part-time employment three years before his original retirement goal and to begin collecting Social Security benefits, which of the following is correct?

   A. Excess dividend and interest income will cause a loss of $1 in benefits for every $3 over a threshold.
   B. The delayed retirement credit will be applicable due to the receipt of benefits after the earliest age of eligibility.
   C. No benefit reduction will apply due to part-time income, irrespective of the amount, because of his full retirement age.
   D. Earned income will result in a loss of $1 for every $2 in excess of a threshold.

4. Based on current rules and the Harrisons' retirement income projections, which of the following is the most likely tax result for their Social Security benefits?

   A. Only 50% of the benefits will be taxable due to the exclusion for defined-benefit plan payments to Brianna.
   B. The maximum marginal tax rate that would apply to their benefits is 85%.
   C. The level of their MAGI (modified adjusted gross income) would subject up to 85% of their benefits to income tax.
   D. Use of municipal bonds would reduce the adverse impact of income tax on John's Social Security benefits.

5. What is Brianna's full retirement age?

A. 62
B. 65
C. 67
D. 70

Topic 61

Multiple Choice Questions

1. When will Brianna be allowed to diversify her ESOP account balance?

   A. After 5 more years of participation
   B. After 6 more years of participation
   C. After 11 more years of participation
   D. After 15 more years of participation

2. What is the maximum amount Brianna can contribute to the ESOP in 2009?

   A. $0
   B. $11,500
   C. $16,500
   D. $49,000

3. If the ESOP distributes shares of TJ&R stock to Brianna when she retires, what option does she have with respect to this stock?

   A. Put option
   B. Call option
   C. Warrant
   D. Leap option

4. Which of the following is true about Brianna's pension plan?

   A. Brianna would have a larger benefit if the plan used a career average pay calculation for her benefit.
   B. Brianna will receive the maximum benefit allowed by a defined-benefit plan.
   C. Brianna's benefit is guaranteed by her employer.
   D. Brianna will benefit from forfeitures related to other employees who quit before they were fully vested in the plan.

5. Which of the following is correct if Brianna's employer decides to convert the defined-benefit plan to a cash balance plan and augment it with a 401(k) plan?

   A. Converting a defined-benefit plan to a cash balance plan will most likely cause Brianna to receive a lower benefit.
   B. Brianna's benefits under the 401(k) plan will be guaranteed by her employer.
   C. Converting to a cash balance plan has been a positive experience for both employers and employees during the past several years.
   D. Converting the plan will result in an immediate 100% vesting of the present value of the accrued benefit in the defined-benefit plan for all employees.

Topic 62

Multiple Choice Questions

1. If TJ&R installs a 401(k) plan as indicated, in order to pass the ADP and ACP tests, which of the following is correct?

   A. The ACP test will be deemed to have been satisfied if the 401(k) is a safe harbor plan.
   B. To pass the ADP test, if NHCEs (non-highly-compensated employees) defer an average of 3%, then HCEs (highly-compensated employees) can defer up to 6%.
   C. To pass the ADP test, NHCEs must have 70% of the deferrals of the HCEs.
   D. The 401(k) plan must cover at least 50 employees or, if less, 40% of all employees.

2. How would Brianna be affected if the 401(k) plan were installed as indicated?

   A. Brianna would have a three-year cliff vesting schedule.
   B. Brianna would have a 2- to 6-year graded vesting schedule.
   C. Brianna would be 100% vested in the employer's contributions immediately.
   D. Brianna would not be affected by the vesting schedule because she is highly compensated.

3. How would Brianna be affected by the Social Security integration rules as applied to the existing ESOP plan?

   A. Brianna would not be affected because an ESOP may not integrate its contributions with Social Security.
   B. Brianna's percentage of compensation deferred to the ESOP would increase with Social Security integration.
   C. Brianna's percentage of compensation deferred to the ESOP would decrease with Social Security integration.
   D. Brianna's employer would be able to increase its contribution to the ESOP with Social Security integration.

4. If the TJ&R defined-benefit plan is found to be top-heavy, which of the following is the impact?

   A. Loans will not be permitted for highly-compensated employees.
   B. The ESOP will be deemed a top-heavy plan.
   C. Lump-sum distributions will not be allowed to highly-compensated employees.
   D. The company must enhance the accrual for non-key employees.

5. Which of the following is correct if the Harrisons decide to take loans from any of their retirement plans to pay for college for the twins?

   A. The loans will be prohibited transactions and subject to taxes.
   B. Any loans will be charged a reasonable rate of interest.
   C. All loans must be paid back within seven years.
   D. Any loans will be based on contributions, not earnings.

Topic 63

Multiple Choice Questions

1. Which of the following is correct if Brianna wants to contribute to her existing IRA account?

   A. She may contribute to the IRA and deduct her contribution.
   B. She may not contribute to the IRA because she is an active plan participant.
   C. She may contribute to the IRA but may not deduct the contribution.
   D. She may not contribute to the IRA because her earnings are too high.

2. What is the maximum amount John can contribute to his 403(b) account in 2009?

   A. $11,500
   B. $14,000
   C. $16,500
   D. $22,000

3. Assume that while the twins were in college, John did not make the maximum deferrals to his 403(b) plan. Which of the following regarding John's future 403(b) contributions is correct once John is over age 50 and has been employed by the museum for over 15 years?

   A. John will be able to make the maximum contribution per participant account, plus the age 50+ and the special 15-year catch-up contributions.
   B. John will not be eligible for the 15-year catch-up contribution, but may make regular deferrals up to the limits, plus the age 50+ catch-up contribution.
   C. John will be able to contribute the maximum deferral and make either the age 50+ catch-up or the special 15-year catch-up contribution, but not both.
   D. John will not be eligible for the special 15-year catch-up contribution because his employer makes a contribution to his account.

4. Which of the following is correct if Brianna wants to convert her IRA to a Roth IRA?

   A. Brianna will not be allowed to convert her IRA to a Roth IRA.
   B. Brianna will be allowed to convert her IRA to a Roth IRA if she files as married filing separately from John.
   C. Brianna will be allowed to convert her IRA to a Roth IRA after she retires.
   D. Brianna will be allowed to convert her IRA to a Roth IRA if John dies this year.

5. Which option is correct regarding Esther's IRA distribution options?

   A. Esther will not have a 10% penalty if she takes immediate distributions because the distributions would be for financial hardship.
   B. Esther may take substantially equal distributions for 10 years and, therefore, have no 10% penalty on the distributions.
   C. Esther may take substantially equal distributions for 15 years and, therefore, have no 10% penalty on the distributions.
   D. Esther may take distributions for her children's medical expenses if the expenses exceed 7.5% of her AGI and have no 10% penalty on the distributions.

Topic 64

Multiple Choice Questions

1. Which of the Harrisons' retirement plans must meet ERISA reporting requirements?

   A. Only Brianna's defined-benefit plan, Brianna's ESOP, Brianna's IRA, and John's SERP
   B. Only Brianna's defined-benefit plan and Brianna's ESOP
   C. Only John's 403(b) plan, Brianna's defined-benefit plan, and Brianna's ESOP
   D. Only John's 403(b) plan, Brianna's defined-benefit plan, Brianna's ESOP, and John's SERP

2. The Department of Labor has primary jurisdiction over which of the responsibilities for the Harrisons' retirement plans?

   A. Reporting, disclosure, and fiduciary responsibilities
   B. Reporting, vesting, and funding
   C. Disclosure, participation, and reporting
   D. Participation, vesting, and funding

3. Who are fiduciaries for the Harrisons' plans?

   A. John's lawyer, providing legal advice
   B. Brianna's CPA, providing accounting and actuarial services
   C. A company rendering investment advice for a fee to John's 403(b) plan
   D. A firm providing design consulting services to Brianna's ESOP

4. Which of the following is not a prohibited transaction between the plan and disqualified persons?

   A. Selling property to the plan for a reasonable fee
   B. Providing office space for reasonable compensation
   C. Exchanging property with the plan at a fair price
   D. Extending credit to the plan at a reasonable rate

5. What reports should Brianna expect to receive from her employer on at least an annual basis, regarding her defined-benefit plan?

   A. Summary Plan Description, Form 5500, Summary Annual Report, and Individual Accrued Benefit Statement
   B. Summary Plan Description and Individual Accrued Benefit Statement
   C. Individual Accrued Benefit Statement, Form 5500, Summary Plan Description
   D. Individual Accrued Benefit Statement

Topic 65

Multiple Choice Questions

1. Which profit-sharing plan design would maximize Brianna's benefit, reduce her taxable income, and minimize costs to TJ&R?

   A. A profit-sharing plan with a contribution formula of 10%
   B. An age-weighted profit-sharing plan with a contribution formula of 20%
   C. A profit-sharing plan with a contribution formula of 25%
   D. A profit-sharing plan with a safe harbor 401(k) plan

2. Which of the following is the best choice for Brianna personally if she establishes a defined-benefit plan for her software company?

   A. A flat benefit or flat percentage benefit
   B. A unit credit plus a percentage of salary
   C. An entry age normal cost method
   D. A safe harbor plan

3. Which of the following provides the Harrisons' employers the largest deduction?

   A. John's 403(b) plan
   B. Brianna's pension plan
   C. Brianna's ESOP
   D. John's SERP

4. The advantages and disadvantages for a cross-tested age-weighted profit-sharing plan with a 401(k) option for Brianna's Software company include all of the following, EXCEPT:

   A. A cross-tested age-weighted profit-sharing 401(k) plan would provide younger employees with a deferral option and allow younger employees to benefit from a longer period of compounding interest.
   B. A cross-tested age-weighted profit-sharing plan would encourage younger, highly-compensated employees, due to the "gateway" requirement of funding at the 5% level.
   C. A cross-tested age-weighted profit-sharing plan would allow Brianna to have a high percentage of the company contribution allocated to her account.
   D. An age-weighted profit-sharing plan inhibits hiring of older employees due to the higher contribution required to fund the plan.

5. Based on the projected demographics, which of the following is the most effective plan design for Brianna's software company in terms of providing excellent benefits for all employees, irrespective of age?

   A. Profit-sharing plan
   B. Target plan
   C. SIMPLE IRA
   D. SIMPLE 401(k)

Topic 66

Multiple Choice Questions

1. The statement of investment policy and objectives for Brianna's software company should contain all the following, EXCEPT:

   A. Historic rates of return for investment categories
   B. Overall target rates of return for investments
   C. Percentage allocations among investment choices
   D. Methods of portfolio evaluation

2. Which of the following plans requires the highest level of fiduciary responsibility regarding the investment inside the plan?

   A. John's SERP
   B. John's 403(b)
   C. Brianna's ESOP
   D. Brianna's pension

3. Which of the following is considered a prohibited transaction?

   A. Use of annuities in John's 403(b) plan
   B. Exclusive investments of company stock in TJ&R's defined-contribution plan
   C. Brianna's suggested investments to the museum for the SERP
   D. John's sale of fixed annuities to participants in the 403(b) plan after proper licensure

4. Qualified plan investment earnings from which one of the following investments may be subject to income tax as unrelated business taxable income?

   A. Income from oil and gas limited partnerships in Brianna's pension
   B. A leveraged stock account with income of less than $1,000 in Brianna's pension
   C. A real estate partnership generating rental income in Brianna's pension
   D. Royalties from an oil drilling limited partnership in Brianna's IRA

5. Which of the following formulas for including life insurance inside Brianna's current employer's pension plan is correct?

   A. The life insurance death benefit is limited to no more than 100 times the expected monthly retirement income benefit.
   B. The life insurance death benefit is limited to no more than 100 times the aggregate cost of the monthly retirement benefit.
   C. The ordinary life insurance premium is limited to less than 50% of the plan contribution.
   D. A term life insurance premium is limited to less than 25% of the plan contribution.

Topic 67

Multiple Choice Questions

1. In which of the following will John be exempt from a 10% penalty for an early distribution from his 403(b) plan?

   A. Taking a hardship distribution for educational expenses
   B. Claiming medical expenses that equal 5% of AGI
   C. Turning 55, separating from service, and then taking a distribution
   D. Taking a series of substantially equal periodic payments during the four years that his twins are in college

2. Assuming that Brianna dies in 23 years and that John survives her, which of the following options is correct regarding required minimum distributions from her IRA?

   A. John may postpone distributions from Brianna's IRA until she would have been 70½, and then he must take distributions from the IRA over his life expectancy.
   B. John may postpone distributions from Brianna's IRA until she would have been 70½ and then he must take distributions from the IRA over no more than five years.
   C. John must begin taking distributions by the end of the year following the year of Brianna's death.
   D. John must begin taking distributions by the end of the year of Brianna's death.

3. If Brianna dies before age 70½, which of the following is correct?

   A. John could disclaim the IRA inheritance and alter the percentages for the children, based on need.
   B. John could choose to postpone any distributions until Brianna would have been 70½, as long as there were separate accounts.
   C. The distributions will be made based on the Uniform Lifetime Table.
   D. If John had predeceased Brianna, beneficiaries would have had to be designated by September 30th of the year following her death, in order to have stretched the IRA distributions over the respective lifetimes of each beneficiary.

4. Which of the following is correct regarding the QDRO payable to Brianna's sister Esther?

   A. The QDRO assures Esther of an immediate distribution.
   B. Esther may roll over the QDRO distribution into an IRA.
   C. Esther will incur a 20% penalty if she takes a QDRO distribution before age 59½.
   D. Esther will have to wait until age 65 to receive the QDRO distribution.

5. If John begins distributions from his 403(b) plan at 65, which of the following is correct regarding cost-basis recovery?

   A. John has no basis in his 403(b) plan.
   B. John's after-tax contributions to the 403(b) plan are recovered tax-free.
   C. Distributions beyond basis are taxed as long-term capital gains.
   D. Employer contributions will be tax-free only on distribution.