Answers to Self Assessment Questions for Chapter 2

1. $10,000 invested today at 5% simple interest will accumulate to $10,500 a year from now. Thus, the present value of $10,500 (payable in 2011) is $10,000 in 2010. $10,000 invested today at 5% simple interest will accumulate to $16,289 in ten years. Thus the present value of $16,289 (payable in 202 is $10,000 in 2010.
2. Normally under the federal income tax code's matching principles, the employer is entitled to a deduction for compensation (current or deferred) when the employee takes that compensation into income. If the retirement plan is a qualified plan, the employer accelerates the deduction presently for contributions made to the plan, whereas the employee defers the inclusion of compensation as income until the time the benefits are actually distributed. In addition, the accumulation of assets under a trust associated with the qualified plan is tax-deferred until distribution.
3. No. A determination letter request is optional but provides comfort for the employer that the terms of the plan document comply with the qualification requirements under the Code. The determination letter opines only on the terms of the plan, not its operation. Thus, a plan with a determination letter could nevertheless be later disqualified if in operation it violates the Code's qualification requirements.
4. No, just those that is applicable to the plan in question. Some of the requirements are applicable only to qualified defined benefit plans, and thus, would not be applicable to qualified defined contribution plans.
5. The following are permitted exceptions to the rule that prohibits the diversion of plan assets: (1) contributions made contingent upon the plan's initial qualification (2) contributions dependent on their deductibility (3) contributions made upon a mistake of fact and (4) for defined benefit plans, excess surplus assets due to actuarial error that exist upon a plan termination.
6. The most the employee could do on his/her own for savings for retirement through a tax-deferred vehicle is an Individual Retirement Account (IRA) which has lower annual contribution limits than the dollar ceiling applicable to §401(k) elective salary deferrals.