

# THE PENSION PROTECTION ACT

## AUGUST 2006

The Pension Protection Act of 2006 was signed into law on August 17, 2006 (PPA). The PPA brings some of the most widespread and significant changes to pension law since the Employee Retirement Income Security Act of 1974 (ERISA). Not only does the PPA deal with pension plans, but defined contribution plans as well as individual retirement accounts (IRA's). The purpose of this article will be explaining some of those changes.

### The Economic Growth and Tax Relief Reconciliation Act (EGTRRA)

On June 7, 2001 the EGTRRA was signed into law, and created some significant changes to retirement plans, including, increased contribution limits for employer plans and IRA's, easing portability rules for employer plans and IRA's and allowing greater tax benefits for the small business owner that start retirement plans. These EGTRRA rules were set to expire beginning in 2011, the PPA made these provisions permanent.

1. **Increased contribution limits to IRA's.** \$3,000 in 2002 to \$5,000 in 2008 with cost of living increases for 2009 and beyond.
2. **Catch-up provisions.** Individuals who are at least 50 years old beginning in 2002 with \$500 and increasing in \$500 increments to \$2000 in 2006 for IRA's. For salary deferral SEP's, 401k, 403b plans, catch-up contributions were permitted at \$1,000 in 2002, increasing in \$1,000 increments to \$5,000 in 2006.
3. **Increased deduction limits.** Deduction limits for SEP IRA's and profit-sharing plans were raised from 15% of eligible employee compensation to 25%.
4. **Increased salary deferral contribution limits.** For 401k, 403b, 457 deferrals start at \$11,000 increasing \$1,000 increments to \$15,000 in 2006. For salary deferral SEP's and Simple IRA's starting at \$7,000 increasing in \$1,000 increments to \$10,000 in 2005. Both will be indexed for inflation.
5. **Portability rules.** The movement of assets between traditional IRA's and qualified 403b accounts and 457b plans have been relaxed.
6. **Roth 401k and 403b.** Employers are allowed to add a Roth component to their 401k and 403b plans which allows individuals the ability to designate their salary deferral contributions as after-tax.
7. **Start-up and expense tax credits.** Allows for tax credits for starting up and administering employer-sponsored plans.
8. **Savers credit.** Individuals with adjusted gross income up to certain amounts receive a non-refundable tax credit of the lesser of 50% or \$1,000 for contribution amounts made to IRA's and salary deferral contributions made to employer-sponsored plans.

### Direct Conversions

Effective for distributions that occur post December 31, 2007 assets from 457b and 403b plans allow for the direct conversion of assets to Roth IRA's as long as the individual's adjusted gross income is \$100,000 or less with a filing status that cannot be married filing separately.

### Exception for the Military

Effective post September 11, 2001 distributions from IRA, qualified plan and 403b accounts will have the excise tax of 10% waived for qualified reservists. There are certain criteria that need to be met to be considered including being called into duty for at least for 179 days.

## **Rollovers by Non-Spouse Beneficiaries**

Effective for distributions from qualified plans, 403b and 457 plans post December 31, 2006 can be rolled over to a non-spouse beneficiary. Under the PPA beneficiaries can roll assets they inherit provided the contribution is processed as a direct rollover.

## **Direct Deposit**

Beginning in 2007 individuals may deposit their tax refunds directly into IRA's

## **New Benefit for Employees of Bankrupt Employers**

Effective post December 31, 2006 and prior to January 2010 employees of bankrupt companies may contribute an additional \$3,000 a year provided the individual was: A participant in a 401k plan whereas the employer matched at least 50% of the salary deferral contribution with employer stocks. The preceding year post additional contribution the employer must have been a debtor in a bankruptcy case and indicted or convicted as a result of the case. The individual must have been a participant for at least six months prior to bankruptcy. One cannot apply both this bankruptcy benefit and catch-up benefit simultaneously.

## **Charitable Distributions from IRA's**

Charitable distributions in 2006 and 2007 are tax-free, otherwise distributions of up to \$100,000 for the year will be excluded from the IRA owner's taxable income, provided the distribution is made on or after the date the IRA owner reaches age 70.5, and is made payable to the charity. The \$100,000 limit is per-year. Different from normal IRA distributions whereas the individual has IRA's that include the amount attributable to rollover of after-tax amounts, and where distributions would include a pro-rated amount of pretax and after-tax amounts, charitable distributions would be deemed to occur first from pretax amounts. This would allow for the individual to retain any nontaxable amount in the IRA for tax-free distributions to self.

## **Combo Plan**

Beginning post December 31, 2009 small employers are permitted to start a combination defined-benefit/defined contribution plan. The assets would be held in trust. Under this combo-plan, separate accounting must occur so as to determine the portion of the plan balance to which specific treatments such as nondiscrimination testing should apply. To be eligible small businesses must employ an average of at least two but no more than 500 employees during the preceding calendar year and at least two on the first day of the plan year.

## **Advisor Exemption**

Effective for investment advice provided after December 31, 2006 with some exceptions. A prohibited transaction exemption has been added under ERISA that allows Registered Investment Advisors to provide investment advice under an "*eligible investment advice arrangement*" to participants and beneficiaries of defined-contribution plans who direct the investment of their accounts under the plan in addition to owners of IRA's, health savings accounts, Archer medical savings accounts, and Coverdell education savings accounts. Under a qualified plan, the investment advice is to be provided using an approved computer model.

In conclusion these are only some of the provisions and nuances under the PPA. Every investor is unique and needs to be walked through the opportunities that the act presents. For further information on how the PPA will affect your own financial situation contact us at (800) 447-0579 at your earliest possible convenience. For more information visit [www.irs.gov](http://www.irs.gov).