



## Pension Protection Act of 2006 Tax Focused Measures

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On August 17, President Bush signed into law the Pension Protection Act of 2006 (PPA). Prompted by the need to address ongoing funding issues facing many traditional defined benefit plans, the law attempts to strengthen pension funds by a number of changes including significantly increasing and accelerating plan contribution requirements.

This bulletin will focus on the tax changes contained in PPA and briefly summarize the funding and disclosure rule changes. Your company should study the impact of the funding and disclosure rules relating to any existing employee retirement plan in detail (which are beyond the scope of this bulletin). You may wish to enlist the assistance of the Perkins & Company pension team and/or your plan's legal counsel to assist with this analysis.

### Single Employer Defined Benefit Plan Rules

- Employers must increase plan funding to 100% over the next seven years.
- Accelerated contributions are required for plans defined as "at-risk," which are generally those funded at 80% or less.
- Allowable plan contribution deductions are increased to the excess (if any) of (1) 150% (140% for multi-employer plans) of the plan's current liability, over (2) the value of the plan assets for plan years beginning in 2006 and 2007. Additional contributions are allowed in subsequent years.
- Assets set aside in a deferred executive compensation arrangement, during a period the plan is at risk, will be currently taxable to the participants. Certain plan provisions will also trigger current taxation. Amounts may be subject to interest and a 20% penalty tax.
- The 10% excise tax on funding deficiencies is still in effect.
- PPA makes permanent the employer-paid termination premium established by the Deficit Reduction Act. The premium (\$1,250 per participant per year for 3 years) is applicable to certain plan terminations.

### Disclosure Rules for Qualified Plans

- Form 5500 for single and multi-employer plans will require more detailed disclosures.
- For plans required to report to the PBGC under Section 4010 of ERISA, additional information will be compulsory, and the criteria for required reporting have changed: if less than 80% of the prior year's funding target is attained, the plan is subject to the reporting requirements.
- Single and multi-employer plans must notify employees of funding status within 120 days of plan year-end.
- Companies are prohibited from requiring employees to invest their own retirement plan contributions in company stock.

### Plan Payout and Rollover Rules

- After 2007, taxpayers will be permitted to make direct rollovers from qualified plans to ROTH IRAs.
- Hardship and non-spousal beneficiary rules are liberalized.

### IRA, 401(k) and Other Retirement Savings Plans

#### Automatic Enrollment

Under the new law, a 401(k) plan with a "qualified enrollment feature" is treated as meeting certain coverage tests and may not be subject to the top-heavy rules. The automatic enrollment feature must meet certain requirements regarding automatic deferral, matching or nonelective contributions, and notice to employees.

#### Tax Refunds

Refunds of individual income tax may now be deposited directly into an IRA.

#### Investment Advice

PPA permits "fiduciary advisors" to offer personalized investment advice to help participants manage their retirement options, and attempts to establish safeguards to ensure that providers act in participants' best interests.

Employers will now be required to educate plan participants about their rights and responsibilities, including asset values, plan funding status, diversified portfolio, investment choices, and tax consequences.

#### Non-Spouse Beneficiaries

The new law allows hardship withdrawals to be taken by any beneficiary, not only spouses and dependents. Additionally, non-spouse beneficiaries can rollover amounts inherited from a qualified plan into an IRA. The beneficiary will avoid tax on the rollover, and will be taxed only when distributions from the IRA are received.

#### Direct Rollovers to Roth IRAs

Beginning in 2008, direct rollovers from 401(k) plans into Roth IRAs will be allowed, and the rollovers will be treated as Roth conversions. (In the past, a taxpayer could achieve the same result, but it required two separate transactions.)

### EGTRRA Provisions Now Permanent

PPA permanently extends many of the benefits of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), which would have otherwise expired in 2010.

- IRA contribution limits increase: \$4,000 in 2006 and 2007, \$5,000 in 2008.
- Additional catch-up contributions for individuals age 50 or older: \$1,000 for IRAs, \$2,500 for SIMPLE-IRAs, \$5,000 for 401(k) plans.
- Continued increases in SIMPLE and 401(k) catch-up contributions: adjusted in \$500 increments based on inflation.
- The new tax law permanently allows for Roth 401(k) and Roth 403(b) plans. Like a Roth IRA, an individual makes post-tax contributions to a Roth 401(k) or Roth 403(b) plan, up to the plan limits. The assets grow tax-deferred and may be withdrawn tax-free in retirement. (NOTE: The Roth 401(k) and Roth 403(b) have been available since the beginning of 2006, but

many employers chose not to amend their plans, since Roth contributions were not expected to be allowed after 2010. As a result of PPA, employers may now want to amend their 401(k) or 403(b) plans before the end of 2006.)

The new law also permanently allows the Saver's Credit, which would have expired at the end of 2006. This nonrefundable credit can be claimed by low- and middle-income taxpayers for their contributions or deferrals to retirement savings plans and IRAs.

Some other notable PPA benefits are:

- Higher dollar limits for defined contribution plans, elective deferrals, 457 plan deferrals, and SIMPLE plan contributions.
- Continued increases in annual benefit limit under a defined benefit plan (indexed for inflation in \$5,000 increments).
- Faster vesting of employer matching contributions.
- Inflation-adjusted deductible amounts for employer contributions to employee plans.
- Start-up credit for new small employer-sponsored plans (\$500 per year for first 3 years).
- Enhanced rollover rules.
- Modifications to the top-heavy nondiscrimination and coverage rules.
- ESOP enhancements, including prohibiting employers from forcing employees to invest any of their own retirement savings contributions in

company stock.

- Continued increases in dollar limits for compensation taken into account (indexed for inflation in \$5,000 increments).
- Greater portability of 457 and 403(b) plans, including higher contribution limits and allowed rollovers.

### Charitable Contributions, Tax-Exempt Organizations, and Sec. 529 Plans

PPA includes provisions to reduce perceived abuses relating to charitable contributions and provides incentives to spur additional charitable giving.

- For 2006 and 2007, taxpayers who have attained age 70-1/2 will be allowed to exclude up to \$100,000 of otherwise taxable distributions from their traditional or Roth IRAs if the distributions are made directly to certain charitable organizations. Such distributions that are excluded from gross income will not qualify for the charitable contribution deduction.
- The ability to deduct donations of food inventory is extended to all businesses through 2007.
- S corporation contributions of property to charity will only require a reduction of shareholder stock basis by a prorated share of the tax basis of the inventory (versus the full amount of the flow-through deduction) through 2007.
- Public schools remain eligible for enhanced donations of book invento-

ries by C corporations through 2007.

- Effective through 2007, the qualified conservation contribution limit is raised to 50% of AGI (and 100% for certain farmer and ranchers) as long as the land is not prevented from being used in farming or ranching.
- PPA permanently extends the rules allowing qualified tuition plans under Section 529, and imposes stricter rules for operating those plans.

The charitable reforms put in place by PPA include the following:

- Taxpayers must have documentation for all cash donations, regardless of amount. Adequate documentation is:
  - Receipt from the charity, showing certain required information;
  - Cancelled check; or
  - Bank statement
- Donated clothing and household items must be in "good condition" (not defined by the new law) to qualify for a charitable contribution.
- PPA also aims to expand federal oversight of charitable organizations through new or enhanced rules, reporting requirements, and penalties.

The PPA changes will affect nearly every retirement plan sponsor and plan participant. To make sure that your plan is ready for the changes, it is important that you talk to your retirement plan advisor as soon as possible.

*This bulletin is a summary and is not intended as tax or legal advice. You should consult with your tax advisor to obtain specific advice with respect to your fact pattern.*

*Based on the most recent "best practice" standards for tax advisors issued by the Treasury Department, commonly referred to as Circular 230, we wish to advise you that this bulletin has not been prepared to be used, and cannot be used, to provide assurance that penalties which may be assessed by the IRS (including specifically section 6662 understatement penalties) will not be upheld.*

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