



# Legislative Brief

## Highlights of The Pension Protection Act Of 2006 (PPA)



On August 17, 2006, in an effort to shore up pension plans and encourage retirement savings, President Bush signed The Pension Protection Act of 2006 (PPA or Act) into law. The PPA is a very broad piece of legislation impacting defined benefit and defined contribution plans. It also makes permanent some provisions of The Economic Growth & Tax Relief Reconciliation Act of 2001 (EGTRRA).

This issue of the FAS-EBA, Inc. Legislative Brief will provide an overview of the rights and obligations provided in the PPA. This Brief is intended to provide a high level overview of the new legislation and is not a substitute for legal or financial advice. There are many additional provisions and requirements contained within the PPA which are not explained within this document. There are four primary areas within the PPA which will be examined below: (1) Pension Reform; (2) EGTRRA Benefit Extensions; (3) New Retirement Savings Benefits; and (4) Charitable Giving. Additionally, some miscellaneous provisions will be highlighted in the fifth section of this Brief.

### 1. Pension Reform

The namesake of the PPA, pensions are obviously at the heart of the Act. The majority of the Act focuses on plan funding and reducing plan shortfalls. It establishes funding requirements and targets, among other things. A plan's funding target is determined by using corporate bond rates averaged over 24 months, using three different rates, depending upon when the benefits are due – bonds maturing within five years, between 5 – 20 years and those maturing beyond 20 years. Note that the funding rules that applied to plan years 2004 and 2005 will generally still apply to plan years 2006 and 2007.

#### *Pension Plan Funding*

Effective in 2008, employers sponsoring single employer defined benefit plans will be required to contribute the normal cost for the year, plus they will be required to amortize funding shortfalls over a period of seven years. Generally effective in 2008, multiemployer defined benefit plans failing to meet certain funding targets will be required to institute funding improvement plans or rehabilitation plans. The biggest multiemployer plan funding change is that benefit increases will be required to be amortized over 15 years, rather than 30 years.

#### *Cash Balance and Other Hybrid Plans*

The Act also addresses the legality of hybrid pension plans, validating their basic design prospectively.

#### *Troubled Plans*

There are three categories under the PPA for "troubled" pension plans: endangered status; seriously endangered status; and critical status. A plan's actuary must certify whether the plan is in endangered or critical status for the plan year within 90 days of the commencement of that plan year. Plans falling into one of these three categories are subject to additional funding rules.

### 2. EGTRRA Benefits Extended

EGTRRA contained many provisions set to sunset after December 31, 2010. The PPA not only made some of these provisions permanent, but it enhanced some of them as well.

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### *Contribution Limits*

The PPA permanently increased contribution limits on IRAs and employer-sponsored retirement plans such as 401(k) plans. Catch up contributions to IRAs and some other employer-sponsored plans by eligible individuals have also been made permanent.

<i>Contribution Limits</i>					
<i>Plan Type</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>
401(k)	\$15k	Adjusted For Inflation (AI)	(AI)	(AI)	(AI)
401(k) catch up	\$5k	(AI)	(AI)	(AI)	(AI)
IRA	\$4k	\$4k	\$5k	(AI)	(AI)
IRA catch up	\$1k	\$1k	\$1k	\$1k	\$1k

### *Maximum Annual Benefit*

The maximum contribution limit for individuals under a defined contribution plan, including employer, employee pre-tax and employee after-tax contributions, is permanently extended by the PPA.

### *Saver's Credit*

The Saver's Credit allows eligible individuals who contribute to a qualified plan to receive a federal "match" for their contributions in the form of a tax credit for the first \$2,000 of their annual contributions. Beginning in 2007, the Adjusted Gross Income requirement will be indexed to inflation.

### *Roth 401(k), 403(b) Plans*

The new Roth plans established by EGTRRA, which allow employees to make after-tax contributions, were made permanent by the PPA.

### *Increased Portability*

The PPA makes permanent the more lenient rules of EGTRRA. Some of the provisions that were made permanent include: after-tax contributions to employer retirement plans can be rolled over into IRAs; and benefits accrued in 403(b) plans or eligible governmental 457 plans may be used to purchase additional service credit in governmental defined benefit plans.

### *529 College Plans*

The PPA makes permanent the provision that allows for qualified withdrawals from 529 college savings plans to be free of federal income taxes.

### *Participant Disclosure Rules*

For plan years beginning after 2006, defined contribution plans must provide a quarterly benefit statement for plans in which participants direct their own investments. An annual benefit statement is required for plans without investment direction. For single employer defined benefit plans, participants with nonforfeitable benefits are required to receive a benefits statement at least once every three years, or upon written request.

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### 3. New/Enhanced Retirement Savings Benefits

The PPA also makes possible enhancements to traditional retirement savings plans. Some key items that were included in the legislation are listed below.

#### *Automatic Enrollment Safe Harbor & State Law Preemption*

Effective for plan years beginning on or after January 1, 2008, employers will be permitted to automatically enroll employees in 401(k) plans by deducting up to 10% of their compensation and to invest the same in default investments. Employees will have the right to opt-out in writing within 90 days of the first deduction. Any conflicting state laws, such as wage and payroll laws, are preempted by the PPA, provided the plan meets certain requirements.

#### *Diversification*

Companies will be prohibited from requiring employees to invest their contributions in company stock and will be allowed to diversify.

#### *Non-spousal Beneficiaries*

For distributions made after January 1, 2007, non-spousal beneficiaries can roll inherited IRA proceeds into their own IRA. Under the prior law, only spousal beneficiaries were allowed this tax-deferred status.

#### *Direct Rollovers*

On or after January 1, 2008, direct rollovers into Roth IRAs will be permitted from qualified retirement plans and certain other plans.

#### *Hardship Withdrawals*

Within 180 days of enactment, the IRS must modify its rules to allow plans to enable participants to make hardship withdrawals for the named beneficiary. Prior to this revision, only spouses and Section 152 tax dependents could benefit from hardship withdrawals.

#### *Disabled Individuals*

Disabled individuals will be able to contribute to an IRA, even if they have no earned income.

#### *Financial Advice*

Beginning in 2007, plan sponsors may offer investment advice under certain conditions, without incurring liability. Plan administrators may also designate default investments for automatic enrollment without incurring liability, also subject to certain requirements.

#### *Accelerated Vesting*

Employer profit sharing and other non-elective contributions must vest under a three year cliff schedule or a six year graduated vesting schedule. Employers have the option to apply the accelerated vesting only to contributions made beginning in 2007 or to all contributions, including those that were made prior to the effective date of the new rule.

#### *Penalty-Free Withdrawals for Active Duty Reservists*

Reservists ordered or called up for active duty between September 11, 2001, and December 31, 2007, for a period greater than 179 days, may take a distribution from a qualified plan without incurring a 10% early distribution penalty tax.

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### 4. Charitable Giving

#### *IRA Distributions*

Distributions from IRAs and Roth IRAs can be donated tax-free to charities through December 31, 2007, provided that the holder of the account has reached 70 ½ years of age.

#### *Tax Deductions*

Tax deductions for cash charitable contributions must be substantiated by a receipt or bank record; no longer will cash contributions be deductible without such substantiation.

### 5. Miscellaneous

#### *Taxation of Death Proceeds – COLI Contracts*

Certain portions of the proceeds from Company Owned Life Insurance (COLI) contracts will now be subject to income tax. Any portion of death benefits in excess of premiums paid will be taxed to the employer unless the insured was employed for any period during the 12 months prior to death or is a highly compensated employee.

#### *Regulations Regarding Qualified Domestic Relations Orders (QDROs)*

Within one year of enactment, the IRS is required to modify its regulations to clarify the requirements for a QDRO to better assist plans with administration.

### More Information

Library of Congress – Legislative History and Text of PPA  
[http://thomas.loc.gov/cgi-bin/bdquery/z?d109:h.r.00004:](http://thomas.loc.gov/cgi-bin/bdquery/z?d109:h.r.00004)

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