

# retirement

## plan news

### The Pension Protection Act of 2006

On August 17, 2006, the Pension Protection Act of 2006 (PPA) was signed into law. Due to its scope, this issue is largely devoted to highlights of the new law. Future issues will feature detailed articles on various parts of PPA.

In general, qualified plan documents will not have to be formally amended to add PPA provisions until the end of the 2009 plan year. Governmental and collective bargaining plans will have two additional years to amend. If the IRS requires an interim amendment before 2009, we will provide you with the timely information you need to update your plan.

**EGTRRA Provisions.** Just a little over halfway to the scheduled sunset in 2011 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), plan sponsors no longer have to worry about pre-EGTRRA limits returning. PPA makes the EGTRRA provisions relating to retirement plans and individual retirement accounts (IRAs) permanent.

These provisions include higher maximum annual salary deferrals to 401(k), 403(b), and 457 plans; catch-up contributions for individuals age 50 or older; designated Roth 401(k) and 403(b) accounts; increased portability between retirement plans; and higher contribution limits for IRAs.

**Saver's Credit.** The tax credit for lower income individuals who save for retirement was scheduled to expire after 2006. PPA not only makes the saver's credit permanent, it calls for the credit's income limits to be indexed to prevent this benefit from being eroded by inflation.

**Pension Provisions.** The PPA makes a host of changes that affect the funding of defined benefit plans and coverage by the Pension Benefit Guaranty Corporation (PBGC). We will address these in a future issue.

**Cash Balance Plans.** The law contains provisions affecting so-called "cash balance" plans and other hybrid retirement plans. PPA imposes requirements on the conversion of defined benefit plans to hybrid plans. The requirements are generally effective for conversions occurring after June 29, 2005.

**Top-heavy Vesting Schedules.** Under PPA, *all* employer contributions to a defined contribution plan must be vested under a top-heavy plan vesting schedule (i.e., a three-year cliff or six-year graded schedule) or faster. EGTRRA imposed this accelerated vesting requirement on matching contributions beginning in 2002. PPA extends it to profit sharing and similar employer contributions.

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The accelerated vesting schedule will go into effect the first day of the 2007 plan year. It must be applied to any participant who works one hour of service in that plan year or a later plan year, and to contributions made after 2006. For ease of administration, plan sponsors may want to consider applying the accelerated vesting schedule to contributions made before 2007 as well.

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# The Pension Protection Act of 2006 *(Continued from page 1)*

**Automatic Enrollment.** To increase retirement savings opportunities, PPA provides several incentives that encourage employers to adopt automatic enrollment. A new automatic enrollment safe harbor, which will allow 401(k) plans to avoid nondiscrimination testing, will be effective beginning with the 2008 plan year. This will be covered in detail in a future article.

## **Investment Advice Prohibited**

**Transaction Exemption.** “Fiduciary advisers” may recommend their own funds without violating fiduciary rules through an “eligible investment advice arrangement” established by PPA. This will also be the subject of a future article.

**DB(k) Plan.** Beginning in 2010, an employer may adopt an “eligible combined plan.” Consisting of a defined benefit plan and a 401(k) plan held in a single trust, the DB(k) plan may be used only by employers with no more than 500 employees. The 401(k) component must provide automatic enrollment and a fully vested 50% match on the first 4% of deferred pay. There are also rules applicable to the benefit provided under the defined benefit feature. We will discuss this dramatic change in a future article.

**Hardship Withdrawals.** Hardship withdrawals may be taken for any beneficiary of a plan participant, even if that beneficiary is not the participant’s spouse or dependent. The U.S. Department of the Treasury is to issue regulations within 180 days after PPA’s enactment.

**Direct Rollovers.** Beginning in 2008, participants will be able to directly roll over distributions from a qualified plan to a Roth IRA. However, these distributions will be taxable at the time of the rollover, which may impact how much a participant can afford to move.

## **Nonspouse Inherited Benefits.**

Beginning in 2007, nonspouse beneficiaries of a decedent’s balance in a qualified plan may roll over inherited amounts to their own “inherited” IRAs. Previously, only surviving spouses could roll over amounts to an IRA or other retirement vehicle. A nonspouse beneficiary must begin taking distributions immediately using a single life expectancy, while a spouse may defer distributions until reaching age 70½.

**Missing Participants in a Terminated Plan.** For the first time, terminating defined contribution plans may volun-

tarily participate in the PBGC missing participant program. Thus, a missing participant’s assets may be forwarded to the PBGC rather than directly rolled over to an IRA. This will be effective for distributions made after PBGC issues final regulations.

**Unemployment and Rollovers.** As of August 17, 2006, states are prohibited from reducing unemployment compensation payments for an individual who rolls over a retirement plan distribution. (Such rollovers avoid taxation.)

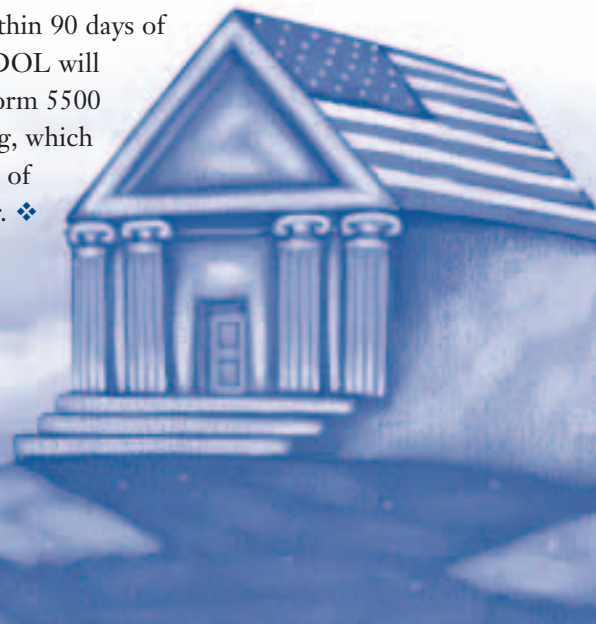
**Tax Refunds to IRAs.** Starting in 2007, taxpayers may request that all or part of a federal income-tax refund be directly deposited into an IRA. IRA contribution limits still apply, which may limit the amount that can be deposited. For example, a taxpayer may not deposit a \$10,000 refund into his or her IRA.

**Bonding Increase.** Effective with the 2008 plan year, the maximum required fiduciary bonding amount for plans that hold employer securities increases from \$500,000 to \$1,000,000. Employers will continue to have the option of obtaining bonds for higher amounts. ❖

## Form 5500 Update

Schedule P has been eliminated from Form 5500-EZ starting with the 2005 year, and from Form 5500 starting with the 2006 plan year. As part of the Pension Protection Act of 2006, Congress has instructed the DOL to create a simpler Form 5500 for plans with fewer than 25 participants for use in the 2007 plan year. PPA also increases the Form 5500-EZ filing threshold from \$100,000 to \$250,000, effective for the 2007 plan year. Finally, the DOL is required by PPA to begin posting Form 5500 annual report information electronically, starting with reports for the 2008 plan year. The information

must be posted within 90 days of receiving it. The DOL will be streamlining Form 5500 for electronic filing, which will be required as of the 2008 plan year. ❖



## PPA Disclosures and Notices

The Pension Protection Act of 2006 (PPA) represents the most dramatic change to the disclosure requirements of the Employee Retirement Income Security Act (ERISA) since it was enacted in 1974. ERISA was designed to protect employees' retirement income by imposing financial disclosure requirements and minimum funding provisions. PPA adds additional disclosure obligations that will provide participants with a better understanding of a plan's assets and how they are invested.

**Statement Requirements.** Before PPA, employers were only obligated to give an active participant an account or accrued benefit statement once a year, and only if a participant requested it in writing. The only other statement requirement applied to a terminated participant with an account balance or accrued benefit, or a participant with a "break in service" during the year.

Under PPA, defined contribution plans (such as 401(k), profit sharing, or money purchase plans) that permit participants to select their own investments must provide statements quarterly. Plans in which fiduciaries direct investments must provide participants with statements annually. Defined benefit plans must send benefit statements to active participants with non-forfeitable accrued benefits at least once every three years, or annually upon written request.

Generally, these requirements go into effect for plan years beginning after 2006. The Department of Labor (DOL) has been instructed by Congress to issue model benefit statements within 12 months of August 17, 2006.

**Funding Notice.** Single and multiple employer defined benefit plans will be subject to a new funding notice starting with the 2008 plan year. The new notice (which is similar to the one required for multi-employer plans) must disclose whether the plan has met its "funding target attainment percentage" for the current year and two preceding years. If the percentage is not 100%, the notice must provide an exact percentage. It must also disclose the plan's total assets and liabilities, its funding policy, any amendments that increase or decrease benefits, and more.



**Rollover Notice.** The rollover or 402(f) notice explains rollover and taxation rules for qualified plan distributions. The time frame for providing the notice has been changed from 30 to 90 days in advance of a distribution to 30 to 180 days prior to a distribution. This will simplify operations for plans administered under the balance forward method, while still allowing the 30-day period to be waived. The rule requiring a minimum of seven days' notice for plans subject to qualified joint and survivor rules remains in effect. The IRS will update the notice to include information about the non-spouse beneficiary rules and direct rollovers to Roth IRAs.

**Notice of Divestiture of Employer Stock.** Beginning with the 2007 plan year, certain plans holding employer stock must permit participants to immediately divest employer securities purchased with elective deferrals (or other employee contributions) and diversify the proceeds into other plan investments. When purchased with employer contributions, plans must allow participants to divest employer securities after completing three years of service.

This requirement does not apply to Employee Stock Ownership Plans (ESOPs) that do not hold elective deferrals or other employee contributions, or employer matching or certain other nonelective contributions. A three-year phase-in period applies to employer contributions in existing plans. The IRS will issue a model participant notice within six months of August 17, 2006. ❖

# recent developments

■ **IRS Priority Guidance Plan.** The IRS has issued its 2006-2007 Priority Guidance Plan. However, because it was created *before* the passage of the Pension Protection Act of 2006 (PPA), the list will be changed to accommodate PPA's new urgent priorities. For example, the IRS has already announced that the final 403(b) regulations will be delayed, and will not be effective until 2008, at the earliest. There are several other items that we hope will remain on the list, including final regulations in the following areas: Roth 401(k) distributions and reporting; Section 415 limitations, including post-severance compensation; and the electronic transmission of notices to participants regarding qualified retirement plan distributions. The IRS will have to work fast to add the PPA requirements to the soon-to-be-issued cumulative list

for 2006. (The annual cumulative list contains the requirements that must be included in plans being submitted to the IRS in the following year. For 2007, this includes individually designed plans for employers with EINs ending in 2 or 7, and document providers' (mass submitters) preapproved defined benefit plans.)

■ **New IRS Publications.** The IRS has issued two new publications: Publication 4530, *Designated Roth Accounts under a 401(k) and Roth 403(b) Plan: Frequently Asked Questions*, and Publication 4531, *401(k) Plan Checklist*.

■ **IBM Case.** A Seventh Circuit Court of Appeals decision found that IBM's cash balance plan did not discriminate against older workers (*Cooper v. IBM Personal Pension Plan*, 7th Cir., No. 05-3588, 8/7/06). This

is the latest chapter in the continuing saga of the conversion of part of IBM's pension plan from a traditional defined benefit plan to a cash balance plan. It is also a reversal of a federal district court determination that the cash balance plan discriminated against older workers.

The PPA of 2006 holds that cash balance plan conversions after June 29, 2005, will not be in violation of the Age Discrimination in Employment Act if certain conditions are met. Although the IRS will issue determination letters for *new* cash balance plans, such letters are not being issued for conversion plans. Because of contrary rulings in the federal circuit courts, a Supreme Court decision may ultimately be required to settle the law regarding cash balance plan conversions prior to June 29, 2005. ❖

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.

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