FPA
FINANCIAL PLANNING PERSPECTIVES

The New Pension Protection Act of 2006 Promotes Savings, Protects Pensions

It's been described as the most sweeping pension legislation in more than three decades. The new Pension Protection Act of 2006, which was signed into law by President Bush on August 17, includes provisions designed to strengthen traditional pension plans that now represent some 44 million American workers and retirees. The new law also does much to promote savings: it makes permanent increased IRA, retirement plan, and catch-up contribution limits, and the tax-advantaged benefits of all 529 college savings and prepaid tuition plans. The new law also eases qualified plans and IRA payout and rollover rules. In addition, the new law includes many changes for charitable contribution deductions and charitable organizations, including eased rules for transfers from IRAs, tightened clothing and household good contribution rules, and stricter recordkeeping requirements for money contributions. Here's a summary of some of the major provisions of the new law that directly affect financial planners and Americans:

Traditional Pension Plans

The new law overhauls the funding and disclosure rules for defined benefit pension plans, changes the rules for conversions of pension plans to cash balance plans, and makes many other changes relating to pension plans and their beneficiaries.

For instance, the new law requires most pension plans to become fully funded over a seven-year period. The new law increased the deduction limits for single- and multi-employer plans, under certain circumstances. And the new law restricts plans from offering any lump sum benefit payments when the plan is less than 60 percent funded. In addition, payouts under nonqualified deferred compensation and special pension plans for executives are restricted for severely under funded plans. With respect to valuing pension liabilities, the new law extends the use of a long-term corporate bond interest rate instead of the 30-year Treasury rate. And the new law revises the rules for calculating the amount of a lump-sum distribution from a defined benefit plan.

The new law also provides legal protection to employers who now provide traditional pension plans but want to convert those plans into hybrid "cash balance" plans, which are part traditional pension and part defined contribution plan. PPA clarifies that this is legal. Under current law, the ambiguity allowed employee lawsuits to emerge challenging the switch.

Retirement Savings Incentives

The Pension Protection Act of 2006 allows employers to automatically enroll workers in defined-contribution retirement plans. And it provides employers with a safe harbor for automatic enrollment, default investment selection for automatic enrollment, and automatic escalation of contributions, as well as 404(c) protection for default elections. The new law also gives workers the right to sell publicly-traded company stock received as a matching contribution in their retirement plan account after three years of service for original matching contributions, and immediately for employee contributions. The new law prohibits companies from forcing employees to invest any of their own retirement savings contributions in company stock. And the new law permanently extends "Saver's Credit" for low-income taxpayers who contribute to an IRA. The Saver's credit was set to expire 12/31/06, and indexes the credit to inflation.

Investment Advice
The new law will also enable qualified fiduciary advisers to deliver personally-tailored investment advice face-to-face, by phone, or electronically for 401(k)s and IRAs, including HSAs, Archer MSAs, and Coverdell education savings accounts.

Under the new law, fiduciary advisers for employer-sponsored plans must base their recommendations on a computer model certified and audited by an independent third party. Advisers who don't use a computer model can charge a fee for their investment advice to 401(k) plan participants, but the fees may not vary based on the investments selected. The Department of Labor and Treasury will develop guidelines regarding computer models "as soon as practicable after the date of enactment".

IRAs
The new law makes permanent the IRA and pension provisions enacted in the 2001 tax cut legislation that were scheduled to sunset after 2010. The 2001 law increased annual contribution limits for IRAs and workplace plans such as the 401(k); created additional catch-up contributions for individuals age 50 and older; and created incentives for small employers to offer workers retirement savings options. Under the new law, the current contribution limit for IRAs of $4,000 rises to $5,000 in 2008 and is adjusted for inflation after that.

The Pension Protection Act of 2006 liberalizes a number of qualified plan and IRA payout and rollover rules. For instance, after 2007, taxpayers who plan to do a Roth conversion would be permitted to make direct rollovers from qualified plans to Roth IRAs vs having to go to a regular IRA. Although technically called a "rollover," it is not. For non-spouse beneficiaries, it is worth noting that this must be a trustee-to-trustee transfer. In other words, a check cannot be issued directly to the non-spouse beneficiary and then deposited into his/her IRA. If it's done this way, this opportunity is lost for good. And non-spouse designated beneficiaries can make rollovers of inherited amounts in qualified plans or IRAs to their own IRAs after 2006. PPA also gives taxpayers the option of depositing a portion of their federal tax refund directly into an IRA and other accounts.

And, in what will surely help older workers continue working on a part-time basis for former employers, defined benefit plans could make in-service distributions to age-62-or-older participants.

Other provisions
PPA also permits insurers to add long-term care insurance riders to annuity contracts and the new law will likely encourage the development of combination products that consolidate various insurance protections into a single product while providing a savings feature.

The new law tightens the rules in areas where Congress perceived abuses in charitable giving. And the legislation permits tax-free IRA transfer rollovers directly to charitable organizations for tax years 2006 and 2007. Only those taxpayers age 70 ½ and older can do this and the tax-free distribution is limited to $100,000 per year.

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