

## THE PENSION PROTECTION ACT OF 2006

H.R. 4, The Pension Protection Act (PPA) of 2006 sponsored by Rep. John Boehner (R, OH), has finally made its way through both the House of Representatives and the Senate. On August 17, President Bush signed the Bill into law. PPA is a massive tax law – almost 1,000 pages of legislative language and a Joint Committee Report of more than 300 additional pages – with the major goal of strengthening pension funds while providing many other tax changes. Many provisions provide the financial professional new variables to consider when advising individuals and businesses on retirement benefits. Here is a short summary of only the major changes.

### PENSION PROVISIONS

The Pension Protection Act of 2006 "requires most pension plans to become fully funded over a seven-year period" starting in 2008, according to a CCH Tax Briefing. "An estimated 30,000 pension plans are now underfunded and will need to put more money into their plans. The Labor Department estimates that plans are currently about \$450 billion underfunded."

To achieve full pension funding, the new law allows employers to deduct the cost of making additional contributions to fund the pension, provides strict funding guidelines, and imposes a 10% excise tax on companies that fail to correct their funding deficiencies. The final provisions are complex and represent the first major pension legislation in more than 30 years.

The same CCH report warns that some pension professionals fear the reform bill could have the unintended consequence of encouraging employers to terminate troubled plans or reduce benefits rather than pay more into their plans to stabilize them.

### IRA, 401(K), AND OTHER RETIREMENT PLAN PROVISIONS

Included in the PPA are provisions and extensions of more than 20 tax benefits for other retirement savings. Many of the benefits enacted by the Economic Growth and Tax Relief reconciliation Act of 2001 (EGTRRA) that were scheduled to expire or 'sunset' were made permanent. Increased limits for IRA contributions will be made permanent. (The limits are \$4,000 in 2006 and 2007, \$5,000 in 2008, and adjusted for inflation after 2008.) Catch-up contributions for individuals age 50 or older will be \$1,000 for IRAs, \$2,500 for SIMPLE-IRAs, and \$5,000 for 401k plans. The catch-up contribution limits will not be adjusted for inflation.)

The new law permanently allows for Roth 401k and Roth 403b plans. Under previous tax law, Roth-type 401k and 403b plans were not allowed after 2010. The new law also permanently allows the Retirement Savings Tax Credit, which would have expired at the end of 2006.

In addition, the new law allows employers to enroll their employees in 401(k) plan automatically - requiring the employee to take positive action to opt out when they wish **not** to participate. Also new are provisions to let IRA, 401(k) and similar providers offer personalized investment advice to account holders. Generally, the investment advice arrangement must provide that any fees or commissions received by the fiduciary advisor do not vary based on the investment option selected, or alternatively, a computer program must be used. The Treasury and

Department of Labor are directed to study the feasibility of applying computer model, investment advice programs to IRAs and similar plans.

There is also an important new provision for non-spouse beneficiaries of a retirement plan. The new law allows non-spouse beneficiaries to roll over assets inherited from a qualified retirement plan into an IRA. The beneficiary will avoid tax on the rollover, and will be taxed only when the assets are withdrawn. Previously, this tax treatment was available only for people who inherited retirement assets from a deceased spouse. The new law will mean more flexible retirement and estate planning for non-spouse beneficiaries, such as domestic partners.

Other changes include:

- Direct pension plan to Roth IRA Rollovers allowed
- Rollovers of after tax annuity amounts to qualified plans
- Enhanced catch-up rules for IRAs when an employer becomes bankrupt
- Reinvestment of ESOP dividends
- Use of annuity contracts for long term care

## **SECTION 529 COLLEGE SAVINGS PLANS**

A late addition to the new law permanently extends the rules allowing for Section 529 qualified tuition plans. New, stricter rules have also been added to prevent abuse. While these plans have been slow to start since EGTRRA, taxpayer funds in those plans doubling in the last year alone.

## **STRICTER RULES ON CHARITABLE DONATIONS**

The Pension Protection Act toughens the tax laws for charitable donations. Under the new law, taxpayers must keep records of **all** cash donations. Individuals must show a receipt from the charity, a canceled check, or credit card statement to prove their donation. No tax deduction will be allowed if the taxpayer cannot provide any supporting documentation. Taxpayers will not need to mail in the receipts with their tax return. Instead, taxpayers will need to keep receipts and other documentation with their copy of the return in the event of an IRS audit.

The new law also toughens the rules for non-cash donations. Donated items, such as cars, clothing, and household goods, must be in good condition. "The new law does not define 'good condition,'" according to CCH. No tax deduction is allowed for items in less than good condition. Kay Bell provides this word of warning, "Perhaps the IRS will, at least for a while in this new requirement's initial stages, start pulling more returns that list donated property and asking filers to confirm the worth of their gifts."

The Pension Protection Act allows taxpayers to donate money to charity directly from their IRA account. The distributions will be tax-free and avoid the penalty on early withdrawals. Taxpayers are allowed to donate up to \$100,000 per year from their IRA. Since the distribution will not be included in taxable income, individuals will not be able to claim a tax deduction for the charitable contribution.

Among other changes regarding charitable contributions, there are new rules that step up the federal oversight of charitable organizations. For example additional standards for credit counseling agencies; enhanced reporting of involvement with donor advised funds; and new rules for charities engaged in potentially abusive life insurance contracts.

## **SUMMARY**

If the congressional intent of this major legislation is indeed born out by the law, the resulting changes will have a significant impact:

- Traditional private pension plans will be strengthened and more solvent.
- Tax saving, retirement benefits that many have enjoyed will be extended, enhanced and made permanent.
- Both charitable donations and charitable organizations will be more carefully scrutinized.

Source: CCH, Inc.  
College for Financial Planning