Pension Protection Act of 2006

On August 17, 2006, President Bush signed into law the Pension Protection Act of 2006 (H.R. 4), the first comprehensive pension legislation in more than 30 years. Although designed primarily to help strengthen traditional corporate pension plans, it also includes a number of provisions that affect employer-sponsored plans, as well as a long-awaited provision affecting the tax-free status of 529 college savings plans.

Understanding the law's key provisions may help you make more informed decisions about your retirement savings.

• **Pension rule overhaul.** To help protect the pensions that many workers rely on, the law applies minimum funding rules beginning in 2008. Employers with defined-benefit plans must meet a 100% funding target, which will be phased in over several years. Companies are required to amortize funding shortfalls over seven years, and there are new "at risk" liabilities. Companies with underfunded pension plans face accelerated contributions and additional insurance premiums.

The law raises the caps on the amount employers can contribute to pension plans, allowing them to build a cushion to help keep their plans solvent. Also, companies are prohibited from promising any extra benefits without paying for those promises up-front. In addition, it changes actuarial assumptions, authorizes a new interest rate, and uses a new mortality table to determine payouts.

• **Higher retirement plan contribution amounts made permanent.** The law makes permanent the maximum employer and employee contribution limits to IRAs, 401(k) plans, and other defined-contribution plans that were established by the 2001 tax law but scheduled to expire after 2010. Annual cost-of-living adjustments are also permanent. In addition, the law allows permanently for Roth 401(k) and Roth 403(b) plans, which were also originally subject to the 2010 sunset provision.

• **Automatic enrollment in 401(k) plans.** Even though the current law allows this, the new law encourages companies to automatically enroll employees in their employer-sponsored retirement plans and to automatically increase employee contributions every year. Although workers can opt out of their plan at any time, automatic enrollment is designed to boost employee participation in 401(k) plans and encourage people to start saving for retirement at an earlier age.

• **Fund sponsors can offer investment advice.** Plan providers that administer employer-sponsored retirement plans will be allowed to offer investment advice to plan participants as long as they use an unbiased computer model to make recommendations.

• **New rules for nonspouse beneficiaries of retirement plans**. One major change allows nonspouse beneficiaries of retirement plans to roll over assets to their own IRAs, avoid current taxes on the rollover, and stretch the distributions over their own life expectancies. Assets will be taxed only upon withdrawal.

Distributions from tax-deferred retirement plans are taxed as ordinary income and may be subject to an additional 10% federal income tax penalty if withdrawn prior to age 59-1/2.

• **Direct rollovers to Roth IRA.** Starting in 2008, the law allows direct rollovers from qualified retirement plans, tax-sheltered annuities, and government plans directly to a Roth IRA. Such a rollover will be treated as a Roth conversion, and all Roth conversion requirements must be met, such as the maximum $100,000 income level before 2010. Current income taxes will be owed on amounts converted.

• **IRA rollovers to charities.** Taxpayers can make tax-free distributions (maximum $100,000 annually) directly from their traditional and Roth IRA accounts to charitable organizations through December 31, 2007. But no charitable deduction is allowed for withdrawals that would have been otherwise taxable.

• **More options for tax refunds.** Taxpayers can direct the IRS to deposit their tax refunds into IRAs.

• **529 tax-free status made permanent.** The December 31, 2010, sunset provision affecting tax-free withdrawals from 529 college savings plans was repealed by the new law, so qualified tax-free withdrawals from 529 plans will be permanent.

The Pension Protection Act of 2006 provides new opportunities for investors. If you have any questions about how this new law may affect your financial situation, call today.