PKF PERSPECTIVES

OVERVIEW: PENSION PROTECTION ACT OF 2006

Important new legislation was recently passed called the *Pension Protection Act of 2006* (the "Act") which addresses numerous changes relating to pension plans and their beneficiaries. Here are some of the key provisions.

Single-Employer Defined Benefit Rules

Among the changes, the Act:

- requires employers to make contributions to their single-employer defined benefit pension plans over the next seven years to make those plans 100% funded. (Formerly, a 90% funding level was acceptable.)
- triggers accelerated contributions for "at-risk" plans.
- permits employers to make additional maximum deductible contributions.
- prohibits further benefit accruals for lump-sum distributions or shutdown benefits from plans funded at less than 60%.
- restricts the use of deferred executive compensation arrangements for employers with severely underfunded plans.

Multiemployer Pension System

The Act's changes include, but are not limited to:

- identifying underfunded multiemployer pension plans and establishing quantifiable benchmarks for measuring a plan's funding improvement.
- providing new notice requirements for underfunded plans.
- requiring plan trustees to improve the health of the plan by one-third within 10 years if a plan is less than 80% funded or will reach a funding deficiency within seven years.
- prohibiting benefit increases if the increase causes the plan to fall below 65% funded status.

New Disclosure Rules for Qualified Plans

One of the themes of the Act is increased disclosure so that workers, regulators and investors can better oversee the financial health of traditional pension plans. To meet this goal, the Act:

- requires both single- and multiemployer plans to include more detailed and specific information on their Form 5500 filings.
- requires both single- and multiemployer pension plans to notify workers and retirees of the funded status of their plan within 120 days after the close of the plan year.
- prohibits companies from forcing employees to invest any of their own retirement savings contributions in the stock of the employer.
- makes it clear that companies have a fiduciary responsibility for workers' savings during "blackout" periods, when workers are temporarily barred from making changes to their 401(K) investments.
- requires companies to give workers quarterly benefit statements that contain information about accounts, including the value of their assets, their rights to diversify, and the importance of maintaining a diversified portfolio.

New Investment Advice Rules

The Act's new rules include:

- permitting qualified "fiduciary advisers" to offer investment advice to help employees manage their 401(K) and other retirement options.
- putting in place fiduciary and disclosure safeguards to ensure that advice provided to employees is solely in their best interest.

Liberalized Plan Payout and Rollover Rules

The following provisions of the Act liberalizing plan payout and rollover rules include:

- after 2007, taxpayers will be permitted to make direct rollovers from qualified plans to Roth IRAs.
- for purposes of the 401(K) hardship distribution rules, effective August 17, 2006, "hardship" includes hardship of a beneficiary under the plan (even if the beneficiary is not a spouse or dependent).
- effective for post-2006 distributions, nonspouse designated beneficiaries are allowed to make rollovers of inherited amounts in qualified plans, governmental Section 457 plans, or tax-sheltered annuities to their own IRAs (treated as inherited IRAs).

- ♦ effective for distributions in plan years beginning after 2006, defined benefit plans can make in-service distributions to age-62-or-older participants.

Retirement Savings Provisions Made Permanent

The Act makes permanent a number of retirement plan and IRA liberalizations that were added to the tax laws in 2001, but were to sunset after 2010. By making the 2001 changes permanent, the new law preserves the advantages of:

- ♦ higher employee contribution limits for employer plans
- ♦ higher IRA contribution limits
- ♦ more flexible plan rules
- ♦ portability
- ♦ a catch-up for those over 50
- ♦ an increase in employer contribution limits
- ♦ permanent saver's credit (which would not have been available after 2006)

Charitable Reforms

The Act also contains a package of provisions to help prevent abuse in the charitable sector and provide additional tax incentives for Americans to give more resources to the charitable community, including:

- ♦ ***Tax-free distributions from IRAs for charitable purposes.*** Effective for two years through 2007, taxpayers can exclude from gross income certain distributions of up to $100,000 from a traditional or Roth IRA if made to a tax-exempt organization to which deductible contributions can be made.
- ♦ ***Charitable deduction for contributions of food inventory.*** An enhanced deduction for donations of food inventory (which was formerly available only to C corporations) is extended to all trades and businesses, effective for two years through 2007.
- ♦ ***Basis adjustment to stock of S corporation contributing property.*** If an S corporation contributes property to a charity, an S corporation shareholder only has to reduce his/her basis in stock of the S corporation by his/her pro rata share of the adjusted basis of the contributed property, rather than by the amount of the charitable contribution that flows through to him/her. This provision is effective for two years through 2007.

The new rules also:

- ♦ double the fines and penalties applicable to certain activities by charities, social welfare organizations, private foundations and exempt-organization managers.
- ♦ require the recapture of any tax benefit derived from the contribution of property with respect to which a fair market value deduction was claimed if the property is not used for an exempt purpose of the donee organization, effective for contributions made after September 1, 2006.
- ♦ generally prohibit deductions for contributions of clothing and household items unless they are in good used condition or better.
- ♦ require that in the case of a charitable contribution of money - **regardless of the amount** - the donor must maintain a cancelled check, bank record or receipt from the donee organization showing the name of the donee organization, the date of the contribution, and the amount of the contribution. This is effective for tax years beginning after August 17, 2006.
- ♦ lower the threshold for imposing accuracy-related penalties on a taxpayer who claims a deduction for donated property for which a qualified appraisal is required.
- ♦ require that unrelated business income tax returns of 501(c)(3) organizations be made publicly available.

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Please note: We have provided only the highlights of the more important changes in the new law.

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