PENSION PROTECTION ACT MAKES MANY CHANGES FOR INDIVIDUALS

On Aug. 17, 2006, the President signed the Pension Protection Act of 2006 into law. This complex 900-plus-page law makes a host of changes relating to pension plans and their beneficiaries, and also revises key charitable giving rules. Its key changes affecting individuals include:

(1) Statutory rules for a relatively new type of company sponsored retirement plan generally called a cash balance plan. This type of plan determines an employee's retirement benefit by reference to his or her “cash balance” in a hypothetical account. Each employee's hypothetical account balance is based on annual pay credits to his or her account, plus interest credits on the account. Cash balance plans tend to favor younger workers over older workers. Traditional pension plans can be converted to cash balance plans, if a number of detailed requirements are met.

(2) Generally effective for plan years beginning after 2006, “defined contribution” retirement plans (such as profit sharing plans) invested only in employer securities must offer participants at least three other investment choices.

(3) Generally effective for plan years beginning after 2006, an accelerated vesting schedule applies to all employer contributions made to “defined contribution” retirement plans (currently, faster vesting applies only to matching employer contributions).

(4) Generally effective for plan years beginning after 2007, retirement plans that provide for a joint and survivor annuity payout option must offer as an option a joint and 75% survivor annuity benefit.

(5) Generally effective after 2006, plans will be able to offer investment advice to participants in plans such as profit-sharing arrangements or 401(k) plans, if certain strict new standards are met. Similarly, fiduciaries will be able to provide investment advice to owners and beneficiaries of IRAs (as well as health savings accounts, Archer medical savings accounts, and Coverdell education savings accounts).

(6) Post-2006 cost-of-living increases to the income limits at which the IRA deduction phases out when an individual (or spouse) is an active participant in an employer sponsored retirement plan. This will result in more active participants being able to make deductible IRA contributions.

(7) Post-2006 cost-of-living adjustments to the income limits at which the ability to make contributions to a Roth IRA phases out. As a result, more taxpayers will be able to make Roth IRA contributions.

(8) For distributions after 2006, nonspouse beneficiaries of retirement plan accounts will be able to make rollovers to inherited-IRA accounts. Currently, only spouse-beneficiaries of retirement plan accounts can make rollovers to IRAs. The change gives much-needed flexibility to those who inherit retirement plan accounts from a non-spouse (such as a parent or uncle).

(9) More rollover options for after-tax contributions to retirement plans. After 2006, such contributions may be rolled over to another retirement plan or to a tax-sheltered annuity, if the

transfer is made via direct rollover and the receiving plan or annuity separately accounts for the after-tax contributions.

(10) After 2007, distributions from retirement plans, tax-sheltered annuities, and governmental Code Sec. 457 plans can be rolled over directly into a Roth IRA, subject to the usual rules that apply to rollovers from a traditional IRA into a Roth IRA. For example, under these rules, a rollover to a Roth IRA generally is taxable, and, until 2010, can't be made if adjusted gross income is $100,000 or more (but the $100,000 rule won't apply after 2009).

(11) For distributions in plan years beginning after 2006, pension plans may make distributions once a plan participant reaches age 62, even if he or she continues working. This change will make it easier for employees to phase into retirement (assuming their employers decide to adopt the change).

(12) Makes permanent many pro-taxpayer retirement plan and IRA changes made by the Economic Growth and Tax Relief Reconciliation Act of 2001 that were supposed to sunset at the end of 2010. These include the ability to make “catchup” contributions to IRAs and 401(k)s after reaching age 50, increases in maximum IRA and Roth IRA contributions, and widened rollover choices.

(13) A new opportunity in 2006 and 2007 for an individual age 70 1/2 or older to exclude up to $100,000 a year of distributions from IRAs (including Roth IRAs) that are paid directly by the IRA or Roth IRA trustee to a qualifying charity. If the exclusion is chosen, the donated amount can't be deducted as a charitable contribution.

(14) Toughened rules for certain contributions. For example, post-Aug. 17, 2006 contributions of clothing and household items that are not in good used condition or better can't be deducted. In addition, the IRS may deny a deduction for any contribution of clothing or a household item with minimal monetary value, such as used socks or undergarments. A deduction may be approved for clothing or a household item not in good used condition or better that has a more than $500 claimed value and is backed up by a qualified appraisal.

(15) New substantiation requirements. A taxpayer won't be able to deduct a post-2006 contribution of cash, check, or other monetary gift unless he maintains as a record of the contribution a bank record or a written communication from the charity showing its name, the date of the contribution, and the amount of the contribution.