

# Pension Protection Act of 2006

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# EGTRRA Permanence

- EGTRRA changes made permanent; including:
  - 415 limit increases (dollar limit and 100% of taxable compensation);
  - Age 50 “catch-up” contributions;
  - 403(b) and 457(b) contribution limits “de-linked”;
  - Elimination of 403(b) MEA limitation;
  - Increase in IRA and Roth IRA contribution limits;
  - Deemed IRA rules;
  - Roth 401(k) and Roth 403(b) plans.

# EGTRRA Permanence (cont'd)

- EGTRRA changes made permanent; including:
  - Automatic rollover rules for involuntary cash-outs of more than \$1,000;
  - Broadening rollover portability to most types of retirement plans or arrangements; and
  - Rollover of after-tax contributions permitted.
- Savers Credit made permanent and indexed for inflation. (Credit is based on AGI and filing status – credit not available if income over \$26,000 for single, or \$52,000 for married, filing jointly.)

Note: Clergy housing allowance not counted under compensation limit for purposes of determining eligibility for Savers Credit.

# Special Church Provisions

- Certain church money purchase pension plans permitted to “self-annuitize” (2006 and later plan years).
- Exemption from UBI tax for leveraged real estate investments held by 403(b)(9) church plans (2006 and later taxable years).
- Non-HCEs covered by church section 401(a) DB plans are not subject to “high three year average compensation” limit under Code section 415(b); only subject to dollar limitation (2007).
- Definition of “convention or association of churches” – change to definition in Code section 7701 to allow the voting membership of such an organization to include individuals.

# Auto-Enrollment and DB/DC Plans

- Automatic enrollment rules enacted (will be covered in detail after conclusion of summary) (generally 2008).
- Special rules are established for DB plans maintained by small employers that are combined with section 401(k) arrangements (2010).
  - Basic concept is establishment of “safe harbor” DB and 401(k) plan for small employers; exempt from certain rules.

# Fiduciary Relief

- This relief is available only to ERISA-covered plans.
- Investment advice can be provided in connection with 401(k) plans and IRAs, despite conflicts of interest; employers exempted from liability in connection with statutorily-approved investment advice arrangements (2007).
- “Mapping” fiduciary relief given in connection with “qualified changes in investment options” and during a lawful “black-out period” (2008).
- DC plan fiduciaries not subject to “safest available annuity standard” when choosing an annuity provider for pension benefit distribution (8/17/06).

# Administrative Changes

- Extended amendment period (end of 2009 plan year) and “anti-cutback” relief provided for plan changes required by PPA.
- IRS voluntary correction program (EPCRS) rules to take into account special problems of small employers, and SCP program to be liberalized.

# Notice, Reporting and Disclosure Requirements

- New rules for periodic benefit statements, tied to type of plan (individual account vs. DB) (2007).
- Notice and consent period for qualified plan distributions, and for election to waive qualified J&S annuity, extended from 90 to 180 days (2007).

Note: This provision also applies to 402(f) notices (special tax notices for eligible rollover distributions).

- Simplified annual reporting (Form 5500) required for plans with less than 25 employees (2007).

# Rollovers

- After-tax contributions can be rolled over from 403(b) to 401(k) plans, and vice-versa (2007).
- Non-spouse beneficiaries can make rollovers to “inherited” IRAs (2007).

Note: IRS guidance makes the following clarifications:

- Applies to 401(a) and 403(b) plans
- Plans may elect but are not required to offer non-spousal rollovers
- Applicable minimum distribution rules are same as those applicable to non-spouse beneficiaries under plan. (Beneficiary cannot delay distributions for “inherited” IRAs.)

# Miscellaneous Retirement Plan Changes

- Hardship withdrawals to be extended by IRS to permit events occurring to non-spouse and non-dependent plan beneficiaries to be treated as hardships (2007).

Note: IRS Guidance makes following clarifications

- Plans do not have to include this provision;
- Hardship event must occur to “primary beneficiary” (i.e., person with unconditional right to all or portion of benefits if participant should die);
- Rules are applicable to 403(b) plans;
- Beneficiary under a 409A or 457(b) plan is treated the same as a spouse or dependent in determining if a participant has incurred an “unforeseeable financial emergency.”

# Miscellaneous Retirement Plan Changes

- DB plans can permit in-service distributions at age 62 (2007).
- No 10% early withdrawal tax on reservists called to active duty after 9/11/2001 and before 2008; withdrawn amounts can be repaid. (Note: Administration Budget Proposal for 2008 would extend this relief through 12/31/2008.)
- Faster vesting schedule applies to all employer contributions to DC plans (5 year 100% vesting and 3 to 7 year vesting replaced with 3 year 100% vesting and 2 to 6 year vesting) (2007).

# IRA Changes

- IRA distributions donated to charity in 2006 and 2007 may be tax-free (up to \$100,000) for each year.

Note: IRS guidance makes the following clarifications:

- Maximum exclusion amount is applicable to each IRA owner, not each IRA account;
- Exclusion applies to distributions from any type of IRA, except a SEP or a SIMPLE IRA;
- Exclusion is available for IRAs maintained after an IRA owner's death if the beneficiary is over 70½; and
- Amount distributed is taken into account for purposes of the minimum distribution requirements.

# IRA Changes

- Rollovers to Roth IRAs from 401(a) qualified plans, 403(b) plans and 457(b) governmental plans permitted if AGI limit is met and tax is paid on otherwise tax-deferred distributions. (2008)
- AGI limitations on traditional IRA and Roth IRA contributions to be indexed for inflation after 2006.

# Automatic Enrollment

# Overview

## Pension Protection Act –

- Clarifies and codifies IRS rulings that permit auto-enrollment.
- Extends ERISA preemption protection to preempt the application of state wage withholding laws to auto-enrollment (effective on August 17, 2006).
- Protects employers from the application of ERISA's fiduciary requirements for investment losses in plan's default investment option (effective for 2007 and later plan years).
- Permits certain corrective distributions (effective for 2008 and later plan years).
- Provides new safe harbors from 401(k) nondiscrimination requirements for plans with automatic enrollment features (effective for 2008 and later plan years).

# Preemption

- Preempts any state law that restricts use of “automatic contribution arrangements” if the following notice requirements met:
  - Annual notice to employees;
  - Notice must provide participant with enough time to make investment election (Note: This may be a problem for new hires);
  - Explanation of right to opt out or make contributions at a different rate; and
  - Explanation of how contributions will be invested in absence of investment election by employee.

# Preemption (cont'd)

- Preemption provision is effective immediately.
- Preemption available only if new ERISA 404(c)(5) default investment rules are satisfied
- Preemption provision is not applicable to non-ERISA plans, including church plans.

Note: Church Alliance is trying to get Congress to extend preemption to church plans as well. (See attachment)

- Failure to provide notice results in civil penalty of up to \$1,000 per day for each violation.

# Fiduciary Relief

- Participants treated as exercising control of investments where:
  - Contributions invested in accordance with DOL regulations;
  - Participants provided with requisite notice within a reasonable period of time before beginning of year; and
  - Participants have a reasonable period after receiving notice and before beginning of plan year to make an election.

Note: No notice required at automatic enrollment – technical correction needed?

# Fiduciary Relief (cont'd)

- Notice must include following:
  - Explanation of right to make investment election; and
  - Explanation of how contributions invested if no investment election is made (i.e., the default investment option must be explained).
- Automatic enrollment notice requirements may be combined into one notice.

# Fiduciary Relief (cont'd)

- DOL issued proposed regulations on “qualified default investment alternatives (“QDIA”) in September 2006.
- Proposed regulations provide safe harbor guidance on appropriateness of designating default investments that include a mix of asset classes consistent with long-term capital appreciation or capital preservation or a blend of both.
- Application of proposed regulations not limited to plans that meet all 404(c) requirements.

# Corrective Distributions

- Corrective distribution from “eligible automatic contribution arrangements” –
  - Maximum corrective distribution must equal all amounts attributable to elective deferrals – no partial corrective distributions.
  - Request for distribution must be made by participant within 90 days after start of contributions.
  - Exempt from early withdrawal 10% penalty tax if election is timely made.
  - Treated as not violating otherwise applicable distribution restrictions on elective deferrals.
  - Not treated as a forfeiture.
  - Related matching contributions must be forfeited.

# Excess Contributions

- Automatic enrollment plans have extended period (6 months after end of plan year) for distribution of excess contributions.
- Timely refunds of excess contributions are taxable in year of distribution (for all excess contributions, not just those made to automatic enrollment plans).
- Gap period income requirement eliminated (for all excess contributions, not just those made to automatic enrollment plans).

Note: These rules apply to both excess contributions and excess aggregate contributions.

# Safe Harbor

Nondiscrimination safe harbor for “qualified automatic contribution arrangement” – plans deemed to satisfy ADP and ACP tests:

- Default rate must equal 3% in first year; increasing 1% each year to 6% in 4<sup>th</sup> year and thereafter, and must not exceed 10%.
- Employer may exclude current employees.
- Employer must make 3% nonelective contribution on behalf of all eligible NHCEs; or a 100% match on NHCE elective contributions up to 1% of compensation, plus a 50% match on contributions from 1% to 6% of compensation.

# Safe Harbors (cont'd)

- Nonelective or matching contributions must be vested within 2 years and are subject to elective deferral distribution restrictions.

Note: Church and “QCCO” plans are not subject to any nondiscrimination rules, even if they use auto enrollment. Safe harbor rules are available to non-QCCO matching arrangements.