The Pension Protection Act of 2006

Good news for investors saving for retirement

On Aug. 3, Congress passed the Pension Protection Act of 2006, which President Bush signed into law on Aug. 17, 2006. This legislation is good news for American workers and provides even more incentive to save for retirement. Here are some of the highlights of the bill:

Makes EGTRRA retirement plan provisions permanent. Originally set to expire in 2010, this bill makes permanent all the retirement plan enhancements created by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), including increased contribution limits and catch-up contributions for investors age 50 and older. This also includes the enhanced tax benefits of 529s, meaning federal income tax-free qualified withdrawals are now here to stay.* In addition, the Saver's Credit, a tax credit available to low- and middle-income workers that was set to expire at the end of this year, is now extended permanently and is subject to indexing for inflation.

Rollover and IRA enhancements. There's more good news for both traditional and Roth IRAs. In the past, many plans offered limited distribution options for non-spouse beneficiaries of qualified retirement plans. With the passing of this bill, non-spouse beneficiaries who inherit qualified plan assets can now roll those assets into a beneficiary IRA. Another change in rollovers is the ability to roll a non-Roth qualified plan directly into a Roth IRA, without having to roll to a traditional IRA first. This eliminates the traditional IRA as intermediary and allows participants who meet the Roth IRA conversion rules (annual modified adjusted gross income is no more than $100,000) to convert their qualified plan distribution to a Roth IRA.

In addition to changes regarding rollovers to IRAs, this bill makes it easier for taxpayers to save for their retirement by allowing them to direct their tax refund to be paid directly to an IRA. Also for the first time, the adjusted gross income limits for traditional IRA deductions and Roth IRA contributions will be indexed for inflation, thereby making both tax-deductible IRA contributions and Roth IRAs available to more investors. For 2006 and 2007 only, IRA owners age 70½ or older may distribute up to $100,000 tax-free from their IRA to a charitable organization.

Small and owner-only business reporting changes. One-participant plans, such as Solo 401(k)s, will no longer be required to file a Form 5500-EZ until they have plan assets of $250,000 (an increase from the current $100,000). This bill also marks the creation of a simplified version of Form 5500 for qualified plans with 25 or fewer employees, decreasing the burden of retirement plan reporting for small employers.

401(k) changes. With the continued decline of defined benefit plans, more and more Americans are relying on employer-sponsored defined contribution plans as their sole retirement savings plan. The government is doing all that it can to increase participation in these plans because they will likely make up the lion's share of retirement income for these investors. To that end, 401(k) plans have recently begun to include an automatic enrollment feature, wherein employees that do not proactively request to be excluded are enrolled in the plan without written consent. This legislation encourages the use of the automatic enrollment feature by making the plan eligible for safe harbor treatment if certain conditions are met:

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- The automatic enrollment percentage initially must be between 3% and 10%, but no less than 4% in the second year, 5% in the third year and 6% for each participation year thereafter.
- The employer must match at least 100% of the first 1% deferred and at least 50% of the next 5% deferred, or provide a 3% nonelective contribution.

In addition, employers may create a vesting schedule for the employer safe harbor contributions, as long as the contributions become 100% vested after 2 years.

Another important change regarding 401(k) and other qualified plans is the creation of a prohibited transaction exemption for "fiduciary advisors" that provide investment advice. Prior to this bill, financial advisors, as fiduciaries of the plan, were generally not allowed to give advice to participants regarding investments. With this exemption, however, an advisor can act in the role of "fiduciary advisor" and provide investment suggestions and advice as long as certain conditions are met. First, the advisor is required to provide written disclosure to participants that he/she is an ERISA fiduciary. Second, the advisor must receive the same fee regardless of the investment options chosen, or the advice arrangement must use a computer model that meets certain conditions set forth by the Department of Labor.

Multiple, sweeping changes in the world of defined benefit (DB) plans. A large portion of the 900 pages in this bill focuses on changes in DB plans. In general, these changes work to protect workers' rights and hold pension plans to a higher standard. In addition to some changes in the interest rates used to calculate contributions and distributions, the bill creates a deadline for employers that sponsor underfunded DB plans. These plans will be required to contribute the normal cost for the year plus amortize any funding shortfalls over seven years. This new rule takes effect in 2008; however, there are transition rules and exceptions included in the bill. "At-risk" plans will be required to make accelerated contributions. A plan would be considered at-risk if the plan was less than 80% funded based on the ongoing liability and less than 70% based on at-risk liability. The 80% target would be phased in. It also asserts the legality of hybrid plans such as cash balance plans and gives guidance regarding treatment of accrued benefits.

For more information on how to take advantage of the new opportunities created by this legislation, call an AIM retirement plan specialist at 800-370-1519—and start building your retirement business today.

Additional information about 529 plans. *Pursuant to the Economic Growth and Tax Relief Reconciliation Act of 2001, effective January 1, 2002. Earnings must be used to pay for qualified higher education expenses to be federally tax free. The earnings portion of a nonqualified withdrawal will be subject to ordinary income tax at the recipient's marginal rate and subject to a 10% penalty.

The information presented in this document does not constitute tax advice. State and local tax laws vary. Additionally, your home state may only offer favorable tax treatment for investing in a plan that your state offers. Please consult your tax advisor for specific information about your tax situation, including any state tax consequences of an investment.

529 plans are subject to enrollment, maintenance, administrative and management fees and expenses.

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Consider the investment objectives, risks, and charges and expenses associated with a municipal fund security (529 plan) before investing. This and other information about a municipal fund security is available in an issuer's official statement, which should be read carefully before investing.

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