Retirement Plan Update

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The Pension Protection Act of 2006

On August 17, 2006 President Bush signed into law H.R. 4, the “Pension Protection Act of 2006” (PPA). A large portion of the PPA deals with Defined Benefit (DB) Plans and trying to ensure they are more properly funded, which at the same time could cause firms to freeze their DB plan in favor of a 401(k) because of the stricter rules. Due to the detail and complexity of these new DB Plan rules a separate mailing will be made to our clients with DB Plans.

Below we provide a simplified overview, with some commentary, of the most important provisions of the Act. They are generally effective in 2007, or for plan years beginning in 2007, unless otherwise noted.

- The maximum vesting schedule in Defined Contribution (DC) plans for all employer contributions, such as 401(k) and 403(b) plans, is a 6-year graded or 3-year cliff. About five years ago the maximum vesting schedule for matching contributions was changed to the afore mentioned schedule, and at that time we advised clients to modify their profit sharing schedule to coincide. Thanks to our advice very few clients will need to make this modification to their plan.
- Non-spouse beneficiaries will be able to roll over distributions due to the death of the participant to an inherited IRA. This rule, effective in 2007, will be a great savings benefit to unmarried couples, children, and other designated beneficiaries.
- Terminating Defined Contribution (DC) plans can transfer the accounts of missing participants to the Pension Benefit Guarantee Corporation (PBGC). Currently limited to DB plans, this will resolve a large problem that plagued firms trying to terminate their plan.
- Beginning in 2008, the Department of Labor will post Form 5500s on their website. Additionally, employers that maintain an intranet site will be required to post their 5500s for employees to review.
- Many of the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) were set to expire in 2010. These provisions, such as the age 50 “catch-up” contribution, and the current deferral limit of $15,000, have been made permanent.
- Default investments are used to deposit contributions when an employee has not affirmatively elected funds. Until now, plan fiduciaries where not necessarily protected from legal action for not properly investing a participant’s account. Now, if an annual notice is provided notifying participants of their right to direct how their account is invested, and what the default fund is, fiduciaries will be protected under §404(c).
- Benefit statements must be provided at least quarterly to plans that allow participants to direct their account, and annually for plans that do not. Special content will be required for plans that allow participant direction.
- The automatic enrollment conflict that existed in some states regarding wage withholding without employee consent has been eliminated. Annual notices to employees will be required. Additionally, an employee can request a penalty-free refund of deferrals and earnings if made within 90 days of the first deferral. Effective for plan years beginning in 2008.
- A new safe harbor option is created for automatic enrollment plans that has a lower match than current safe harbors and allows a two-year cliff vesting schedule versus immediate vesting. The minimum automatic enrollment percent is 3% to 6% and the match formula is 100% of the first 1% deferred and 50% of the next 5% deferred. We believe that this will be a seldom used provision as it will cost employers more to match auto-enrolled participants rather than the current safe harbor that only matches participants that elect to make contributions. Additionally, this provision also requires that the deferral percent for automatically enrolled participants be increased each of the first several years – a task that doesn’t sound so automatic for the employer.
- Plans that use the current non-safe harbor automatic enrollment option will have 6 months to perform the ADP/ACP test and make corrections, rather than the current 2½ months.

Do you have an enrollment period coming up? Give us a call and we will arrange for a representative from your investment company and/or an RPA representative to attend your enrollment meeting.

Pension Protection Act (con't)

- Beginning in 2008, direct rollovers can be made into Roth IRAs. These rollovers would be subject to the Roth IRA conversion rules in effect at the time, and would still be a taxable event for the participant. The participant would need to determine if they can afford the taxes on a complete rollover and conversion prior to making the distribution.
- Reservists called to duty for a period of more than 179 days can make penalty-free withdrawals from qualified plans and IRAs. The withdrawal must be made during the active duty period.

Amendments reflecting the changes made in the Pension Protection Act are generally required to be adopted by the end of the 2009 plan year. ❖

Final 401(k) Regulations

In December we will be sending you an amendment package to amend your plan for the Final 401(k) and 401(m) Regulations, which were originally proposed in 2003. The IRS requires plans to be amended by the filing due date of the 2006 Form 5500. The Regulations include statutory changes and other IRS guidance issued since 1994. This includes, but is not limited to, expanded reasons for safe-harbor hardship withdrawals, restrictions on the use of QNECs and QMACs, clarification of safe harbor rules, and gap period income. ❖

Deposit 401(k) Deferrals IMMEDIATELY

The Department of Labor (DOL) rules state that employee deferrals and loan payments must be deposited as soon as the amounts can be separated from the employer's general assets, but no later than the 15th business day of the following month. Recent investigations and rulings show that the DOL is enforcing this rule, and that the DOL believes many employers can remit deferrals to the plan within days after each payroll cycle. ❖

To Check Or Not To Check Box 13 of the W-2

The IRS instructions for this item say the Retirement Plan box is to be checked if the employee was an "active participant" for any part of the year. The instructions go on to say that an employee is an active participant if he/she is covered by a defined benefit or participates in a defined contribution (e.g. 401k) plan for any tax year that employer or employee contributions are added to his or her account. By this definition, if the employee did not defer, and no employer contributions were deposited to their account, then Box 13 should not be checked. Please consult your payroll/finance advisors if you are not sure whether box 13 should be checked.❖

2006 Plan Limits

401(k), 403(b), 457 Deferral	$15,000
401(k), 403(b), 457 Catch-up	$5,000*
Maximum Compensation	$220,000
DC Plan 415 Limit	$44,000
Social Security Wage Base	$94,200
SIMPLE Deferral Limit	$10,000
SIMPLE Catch-up	$2,500*
HCE Comp. Determination	$100,000
Top-Heavy Key Employee	$140,000
Defined Benefit 415 Limit	$175,000
Traditional/Roth IRA	$4,000
Traditional/Roth IRA Catch-up	$1,000*

*Available to participants who will be age 50 or older by December 31.

The IRS should release the 2007 Cost Of Living Adjustment increases in October 2006 at which time we will notify you.

Reminders & Tid-bits:

Summary Plan Description
You must give a copy of the Summary Plan Description (SPD) to every newly eligible participant within 90 days of their becoming eligible.

Safe Harbor Contribution Notices
If your plan is utilizing Safe Harbor Contributions to avoid certain tests, you must hand out your Notice to participants 30 days before the beginning of your plan year. Additionally, if you are using the 3% of compensation "may" notice, you must hand out your final decision notice at least 30 days before the end of the plan year.

Fidelity Bond
A Fidelity Bond protects the plan assets against fraud. Regulations require a plan to have a Fidelity Bond for no less than 10% of the plan assets. Not having a Fidelity Bond can subject even the smallest of plans to a costly annual audit. Be sure to project the plan assets for the next couple of years to avoid having to request an increase each year.