Northwestern Mutual

Advanced Planning

Pension Protection Act of 2006

On August 3, 2006, the Senate passed the Pension Protection Act. The legislation, which is expected to be signed into law by the President on August 17, contains significant pension reforms including permanent extensions of many of EGTRRA's retirement savings provisions. Among its other provisions, the law creates new requirements for employer owned life insurance and incentives for long term care insurance and charitable gifts. This article identifies the Act's key provisions (for more details, see the Explanation by the Joint Committee on Taxation). A complete analysis will be available soon.

I. Pension Reform

- Makes permanent the increased pension and individual retirement account (IRA) contribution limits, the Savers' Credit and other pension rules under EGTRRA.
- Permits direct deposit of tax refunds into IRAs (effective for tax years beginning after December 31, 2006).
- Provides safe harbor treatment for defined contribution pension plans with automatic enrollment (effective for plan years beginning after December 31, 2007).
- Allows non-spouse beneficiaries to transfer benefits to an inherited IRA (effective for distributions after December 31, 2006).
- Changes minimum funding standards for single-employer and multi-employer defined benefit pension plans (effective for plan years beginning after December 31, 2007).
- Permits direct rollovers from retirement plans to Roth IRAs (effective for distributions made after December 31, 2007).
- Relaxes rules for fiduciaries that provide investment advice, sell securities pursuant to the advice, or receive fees (effective after December 31, 2006).
- Establishes added reporting and disclosure rules for qualified plans (effective for plan years beginning after December 31, 2007).
- Allows for the creation of a combined defined benefit-401 (k) plan for employers with no more than 500 employees (effective for plans years beginning after December 31, 2009).

II. Employer owned life insurance requirements

- Subjects death benefit of employer-owned life insurance (COLI) to income tax unless certain requirements are met.
- Requires employers to notify employees that COLI will be purchased and obtain their consent before the policy issue date.
- Establishes certain eligibility requirements (e.g., employee compensation levels) in addition to the notice/consent requirements.
- Requires employers to file annual COLI information returns with the I.R.S.
- Applies to policies issued after the date of enactment unless the policy is issued pursuant to a 1035 exchange of a grandfathered policy. However, a material increase in the death benefit or other material change after the date of enactment may cause a policy to be treated as newly issued.

III. Charitable Incentives

- Allows IRA owners, after age 70½, to make a distribution up to $100,000 per year to a qualified charity without including the amount in income. Effective in 2006 and 2007 only.
- Requires charitable organizations participating in the purchase of certain pools of life insurance contracts (sometimes referred to as "ChOLI" arrangements) to disclose their participation.
- Increases several of the excise taxes related to public charities and private foundations.
- Denies deductions for donations of clothing and household items unless the items are in "good used condition or better."
- Requires donors to keep records of all donations made by cash or check in order to claim a deduction.
- Creates new rules for contributions of fractional interests in tangible personal property.
- Establishes numerous additional reporting requirements.
- Subjects donor advised funds and supporting organizations to additional regulation and excise taxes.

IV. Long Term Care Insurance

- Allows income tax free withdrawals from an annuity and life insurance contract's cash values for coverage under long term care insurance that is a part of or a rider on the annuity or life insurance.
- Expands tax-free exchanges of life insurance, annuity and endowment contracts for long term care contracts.
- Applies to tax years beginning after December 31, 2009.

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