NATIONAL BENEFIT SERVICES, INC.
CLIENT BRIEFING
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PENSION PROTECTION ACT OF 2006: IMPACT ON PROFIT SHARING AND 401(k) PLANS

Introduction

Called the most significant retirement plan legislation since ERISA, the Pension Protection Act of 2006 (PPA) signed into law on August 17, 2006 makes important changes affecting both defined benefit and defined contribution plans.

While much of the attention in the popular press has been focused on the defined benefit funding aspects of the new law, we believe that the most far reaching impact will be on profit sharing and 401(k) plans. And for the most part highly favorable to plan sponsors and participants.

Future *Briefings* will provide you with details of the Act's provisions affecting such areas as:

- Safe harbor default investments
- Investment advice for participants
- New fiduciary liability relief
- Tax planning opportunities

This issue will provide you with the highlights of the most significant changes affecting these defined contribution plans and our commentary on the changes.

EGTRRA Benefit and Contribution Limits Extended

The sun will not be setting on the favorable retirement plan tax provisions that were part of the Economic Growth and Tax Reconciliation Act of 2001 (EGTRRA).

That law included more than 3 dozen rules which provided significant increases to contribution and benefit limits for qualified retirement plans and Individual Retirement Accounts (IRAs).

The new Act makes permanent the EGTRRA rules beyond the 2010 sunset date.

Commentary. If the EGTRRA limits had been allowed to expire, the contribution and benefit limits would have reverted to the 2001 limits. This would have result in significant contribution reductions after 2010.

The following chart shows the current benefit and contribution limits under EGTRRA, and what the limits would have been if EGTRRA had not been extended.

Type	Limit in 2006	If No Extension
401(k)	$15,000	$13,500
401(k) Catch-Up (Age 50+)	$5,000	$0
IRA	$4,000	$2,000
IRA Catch-Up (Age 50+)	$1,000	$0
SIMPLE	$10,000	$8,000
SIMPLE Catch-Up (Age 50+)	$2,500	$0

The benefit and contribution limits will continue to be adjusted for inflation.

Roth 401(k) 2010 Sunset Provision Eliminated

The Roth 401(k) option has been permanently extended which was also otherwise set to expire in 2010.

Commentary. This removes much of the uncertainty plan sponsors had in adding this option to their 401(k) plans. We believe that most clients should adopt the Roth option in order to:

- Provide participants with the opportunity to diversify their future tax burden
- Keep their plans competitive with other employers

Employee Saving Encouraged with New Safe Harbor Available

The Act boosts enrollment through automatic 401(k) enrollment. If automatic enrollment is used, a new safe harbor is available to meet non-discrimination rules. This provision is effective for plan years beginning after December 31, 2007.

Commentary. We will discuss the practical considerations in deciding whether to implement automatic enrollment in a future *Briefing*.

ERISA Fiduciary Rules Relaxed

The new law extends relief to plan fiduciaries under Section 404(c) of ERISA in 3 important areas, the practical aspects of which will be discussed in future *Briefings*.

1. *Default Investments*. The Act permits the use of default investment choices beyond money market and stable value funds that plan sponsors can use for employees who do not make investment elections beginning after January 1, 2007.

2. *Investment Advice*. The Act also encourages plan sponsors to make investment advice available to 401(k) participants beginning after January 1, 2007.

3. *Blackout Periods and Mapping*. Under the new law, plan fiduciaries will receive Section 404(c) relief during a blackout period, provided they comply with general blackout notice rules.

   They will also receive 404(c) relief for *mapping*, provided that certain requirements are met. Mapping is that process in which accounts invested in old funds are automatically transferred to comparable new funds.

   Commentary. These provisions are effective for plan years beginning after December 31, 2007.

IRA Rules Expanded

The new law significantly provides new tax planning and distribution opportunities using IRAs in 4 areas.

1. *Direct Transfer of Tax Refund to IRA*. This provision is available for the 2007 filing season.

   Commentary. If advantageous, a taxpayer can then subsequently transfer the funds to a qualified retirement plan.

2. *Direct rollover to Roth IRA*. Beginning in 2008 a distribution from a qualified retirement plan can be rolled over directly to a Roth IRA provided the current Roth conversion rules are met.

Commentary. Prior to the new law, distributions from a qualified retirement plan could not be rolled over to a Roth IRA. The rollover had to be a 2-step process. First, from the qualified retirement plan to a traditional IRA and then to the Roth IRA.

3. *IRA Distribution to Charity*. For 2006 and 2007, a tax free distribution of up to $100,000 per year can be made from an IRA directly to charity if the following conditions are met:

   - The donor is over age 70 ½ ,
   - The distribution would otherwise have been taxable, and
   - The donation cannot be used to increase the allowable deduction for charitable contributions on an individual's tax return.

   Commentary. Amounts distributed from IRAs are generally taxed as ordinary income with charitable contributions deductible under special rules. The new law provides a two-year window if the above requirements are met.

4. *Rollover by Non-Spouse Beneficiary*. Prior law did not permit a non-spouse beneficiary to rollover the participant's benefit into an IRA. Beginning January 1, 2007, a non-spouse beneficiary can transfer inherited qualified retirement plan benefits into an inherited IRA.

   Commentary. The new law will provide greater estate planning opportunities and additional distribution options to non-spouse beneficiaries.

Hardship Rules Expanded

Hardship distributions from qualified retirement plans can only be made on account of a financial hardship of the participant.

Under the new law, hardship distributions from qualified retirement plans can be also be made on account of hardship or unforeseeable financial emergency of any person who is the participant's beneficiary even if that person is not the participant's dependent for tax purposes. This change became effective immediately upon enactment of the Act. The Secretary of the Treasury must issue regulations within 180 days after the enactment of the law.

Commentary. The new law permits a hardship distribution to be made on account of a financial hardship or unforeseeable emergency of a parent, grandchild, or domestic partner.

Faster Vesting of Employer Non-Elective Contributions

Effective in 2007, employer non-elective contributions must vest according to rules applicable to matching contributions, i.e., under

- 3-year cliff vesting under which contributions are 100% vested after 3 years of service, or
- 6-year graded vesting in accordance with the following schedule:

Years of Service	Vesting Percent
1	0%
2	20%
3	40%
4	60%
5	80%
6	100%

Commentary. The new minimum vesting requirements should have little if any impact on client plans which generally provide vesting at least as rapid.

More Frequent Benefit Statements

Current law requires Plan Administrators to provide benefit statements to participants only upon request, but not more than once per year.

Effective in 2007, the new law requires that Plan Administrators must provide a benefit statement

1. At least once a quarter to participants in plans in which they can self-direct their accounts,

2. At least once a year to participants in plans in which they cannot self-direct the investment of their accounts, and

3. Upon request to any beneficiary.

Commentary. The Act will have little or no impact on client plans which provide benefit statements on a basis at least as frequent as required by the new rules.

Diversification of Investments in Employer Stock

Under current law, Plan Administrators can require that certain plan assets be invested in employer stock without giving participants the right to select alternative investments. Effective in 2007, participants must be given the right to diversify their investments in employer stock. Exception to the new law are provided for certain privately-held companies and Employee Stock Ownership Plans.

Commentary. The new law is generally applicable to those plans that require that a portion of contributions be invested in employer stock.

About National Benefit Services, Inc.

Founded in 1978, National Benefit Services, Inc. provides retirement plan consulting and administrative services for a wide range of privately held and publicly traded employers.

Clients include business owners and employers in a wide range of industries in the United States, Canada, and overseas.

Our activities are focused on the design and administration of qualified retirement plans using innovative plan design techniques to accomplish the plan sponsor's objectives.

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