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Good News in the Pension Protection Act

by Larry Shippee

Since the Pension Protection Act passed Congress last August, actuaries and pension administrators have been sorting through the legislation to get a handle on the impact. And it's no small impact. This is the most significant change since ERISA itself in 1974. This article will address the changes that will have the greatest impact on the small plan sponsor.

Higher Deduction Limits

The act allows an employer to contribute up to 6% of pay to a Defined Contribution plan even if the employer maintains a Defined Benefit plan. Previously an employer could only do this if the contributions to both plans did not exceed 25% of payroll. The 6% DC contribution is now available regardless of the level of Defined Benefit contribution.

Many sponsors of Defined Benefit plans will now put in DC plans and vice versa. This also means a sponsor of a Defined Benefit plan can add a 401(k) plan and make a safe harbor contribution, thus eliminating the need for a minimum level of employee participation.

This change takes effect for the 2006 plan year and we have already seen many employers take advantage of it.

More Higher Deduction Limits

Prior to the act, Defined Benefit plans had a limit on deductible contributions that allowed funding up to 100% of Current Liability. Current Liability is a term defined in Section 412 of the Internal Revenue Code and generally refers to the current value of all benefits accrued. The act changes the 100% limit to 150%. This can have an enormous effect on the funding limits for some plans.

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"The act allows an employer to contribute up to 6% of pay to a Defined Contribution plan even if the employer maintains a Defined Benefit plan."

The new limit has some restrictions if the plan was amended recently and the ultimate benefit that can be paid out is still capped. It will, however, allow some employers the opportunity to fund that benefit on an accelerated schedule.

Cash Balance Plans

Cash balance plans are a hybrid between Defined Benefit Plans and Defined Contribution Plans. Prior to the act, there was a great deal of uncertainty about the rules that apply to these plans. The act spells out many of the requirements clearing the way for use of this type of plan.

Automatic Enrollment

Some 401(k) plans automatically enroll new employees without any action required on the part of the employee. If the employee chooses not to participate, or to participate at a different percentage, they must actively make that election. Results have indicated that overall participation rates are higher when the plan operates this way.

The act not only clears the way for this approach, it provides some incentives for employers to use automatic enrollment. If the plan fails the discrimination test and is forced to refund money to the Highly Compensated Employees, the deadline for making the refunds is 6 months after the end of the plan year if automatic enrollment is used. Otherwise the deadline is 2 ½ months.

Prior to the act there were 2 ways for a 401(k) plan to meet the Safe Harbor requirements and thus avoid the discrimination test completely. The act creates two more alternatives for plans that use automatic enrollment starting in 2008. To meet the new Safe Harbor requirement the employer would be required to either make a 3% contribution for all eligible employees or a matching contribution of 100% of the first 1% of pay plus 50% of the next 5% of pay. These contributions would be 100% vested after 2 years of service unlike the current safe harbor options that require immediate 100% vesting.

DB(k)

The act creates a new type of plan that has the features of a Defined Benefit plan but allows employees to make 401(k) contributions. This plan is only available to employers with

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fewer than 500 employees and is not available until 2010. The rules contain a number of restrictions on the plan's features that may make it unattractive for many employers.

Non-spouse Rollovers

For the first time a non-spouse beneficiary would be permitted to roll over benefits to an IRA so that the IRA could satisfy the minimum distribution requirements rather than the plan. This is effective in 2007.

The Rest

Some of the other changes made by the act are:

- A complete overhaul of the Defined Benefit funding rules with most of the changes taking effect in 2008
- Rollovers to Roth IRAs will be possible in 2008 with the taxable portion of the rollover taxed at the time of the rollover. These would be subject to the Roth conversion rules (no more than $100,000 adjusted gross income).
- The vesting requirements for all Defined Contribution plans are increased to 100% after 3 years or 20% per year starting with the second year.
- Benefit statements would now be required (1) quarterly for participant directed Defined Contribution plans, (2) annually for trustee directed Defined Contribution plans and (3) every 3 years for Defined Benefit plans.

There are a number of other changes made by the Pension Protection Act. If you have any questions about how you or your plan might be affected feel free to contact us.

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2007 Plan Limits

401(k) Plan Limits for Plan Year	2007	2006	2005
401(k) Elective Deferrals	$ 15,500	$ 15,000	$ 14,000
Annual Defined Contribution Limit	$ 45,000	$ 44,000	$ 42,000
Annual Compensation Limit	$225,000	$220,000	$210,000
Catch-Up Contribution Limit	$ 5,000	$ 5,000	$ 4,000
Highly Compensated Employees	$100,000	$100,000	$ 95,000
Non 401(k) Related Limits			
403(b) / 457 Elective Deferrals	$ 15,500	$ 15,000	$ 14,000
SIMPLE Employee Deferrals	$ 10,500	$ 10,000	$ 10,000
SIMPLE Catch-Up Deferral	$ 2,500	$ 2,500	$ 2,000
SEP Minimum Compensation	$ 500	$ 450	$ 450
SEP Annual Compensation Limit	$225,000	$220,000	$210,000
Social Security Wage Base	$ 97,500	$ 94,200	$ 90,000
Defined Benefit Limit	$180,000	$175,000	$170,000

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