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Pension Protection Act of 2006

Watch For Additional Retirement Savings and Charitable Giving Opportunities

By John J. Hess

On August 17, 2006, President Bush signed into law the Pension Protection Act of 2006 (PPA). This more than 900-page law is the most significant pension legislation since ERISA was enacted in 1974. PPA offers many planning opportunities, including those relating to IRAs and defined contribution plans (such as 401(k) plans) and charitable contributions. Some of these opportunities are discussed below.

Direct Deposit of a Tax Refund into an IRA. Beginning in 2007, a taxpayer will be able to instruct the IRS that all or a portion of his income tax refund be directly deposited into an IRA for himself (or his spouse in case of a joint return). This will make it much easier for someone to make an IRA contribution. However, the rules relating to the timing and limit on such contributions are not changed by PPA. Thus, if an individual is ineligible to make a contribution to an IRA for a tax year because his or her income is too high, then this new provision will not be available to that person.

Direct Rollovers from a Qualified Plan into an IRA of a Non-Spouse Beneficiary. Currently, it is not permissible for a non-spouse beneficiary to roll over into an IRA any distribution received from a qualified plan (such as a 401(k) plan). Beginning in 2007, a non-spouse beneficiary will be able to have a distribution that is otherwise eligible (such as a lump sum payment) be directly rolled over into that person's IRA. Currently, a non-spouse beneficiary who receives a lump sum distribution from a qualified plan (generally the required form of distribution from defined contribution plans) has to include the entire amount in income in the year of receipt. Next year such a beneficiary can defer taxation on such a distribution by having it directly rolled into that person's IRA, where distributions do not have to begin until the year following the year the plan participant dies and such distributions can be made over the beneficiary's life expectancy. This offers significant tax planning opportunities since it will allow the non-spouse beneficiary to spread the recognition of taxable payments over a period of many years while allowing the assets in the IRA to accumulate investment income on a tax deferred basis, thereby increasing the total benefit to such person after taxes have been paid. In a case of a beneficiary who is the child or grandchild of the deceased participant this period could be very significant.

2001 Tax Act Increases to Limits on Contributions to Qualified Plans and IRAs are Made Permanent. PPA makes permanent the provisions of the 2001 Tax Act that were to expire after 2010. These include the annual higher annual contribution limits for IRAs (currently $4,000) and defined contribution plans (currently $15,000 for pre-tax 401(k) plan contributions with a total limit of $44,000 for all contributions) and catch-up

A Note from the Editor

This Winter 2006 issue of *Estate Planning & Tax Advisor* is being released early to allow our readers time to consider and implement the unique tax planning opportunities resulting from the Pension Protection Act of 2006, some of which are available only in 2006 and 2007.

—Abbe I. Herbst

who's who

John J. Hess

John J. Hess is a shareholder in the New York office of Anderson Kill & Olick, P.C. Mr. Hess has extensive experience in the areas of tax law, employee benefits and ERISA.

(212) 278-1811
jhess@andersonkill.com

Helpful Tip: *In view of the changes to the direct rollover rules for non-spouse beneficiaries of 401(k) and other defined contribution plans, a review of beneficiary designations under such plans might offer significant tax planning opportunities. For example, if a daughter or son of the participant is the sole beneficiary it might be advisable to name one or more grandchildren (or a trust for their benefit) as additional beneficiaries since this would result in further deferring the recognition of income by these younger beneficiaries.*

Member's Listing

Phillip J. Benoit, CPA (212) 278-1348
pbenoit@andersonkill.com

James G. Clements (212) 278-1244
jclements@andersonkill.com

Phillip England (212) 278-1483
pengland@andersonkill.com

Abbe I. Herbst, Editor (212) 278-1781
aherbst@andersonkill.com

John J. Hess (212) 278-1811
jhess@andersonkill.com

Mary E. McGuire, EA (212) 278-1801
mmcguire@andersonkill.com

The firm has offices in New York, Chicago, Greenwich, Newark, Philadelphia, and Washington, D.C.

contributions for those age 50 and over (currently $5,000 for defined contribution plans and $1,000 for IRAs). This will provide increased tax-favored savings for contributions to qualified defined contribution plans and IRAs after 2010.

Certain Direct IRA Transfers to Charities are Tax-Free for 2006 and 2007. Prior to 2006, an individual who wanted to make a charitable contribution of assets held in an IRA would first have to receive a taxable distribution from the IRA (and recognize income) and then make a tax-deductible contribution to the charity. As a result of PPA, direct transfers from an IRA to certain public charities in 2006 and 2007 will be excluded from the gross income of the IRA owner up to $100,000 per year. There are various limitations on this benefit, one of which is that the IRA owner must have attained age 70 1/2 when the transfer was made. In addition, no charitable deduction is allowed for the amount excluded from gross income. Such transfers can result in greater tax benefits for charitable giving. For example, the effect of the direct transfer to the charity is to completely offset the income that would have otherwise resulted from the IRA distribution (which is not necessarily the case under current law). Furthermore, such transfers are treated as satisfying (in whole or part) the minimum distribution requirements that are imposed on IRA owners who have attained age 70 1/2 and, thus, reduce or eliminate the required taxable distribution from the IRA for that year.

There are certain requirements which must be met. For instance, if the amount transferred to the charity would not have been otherwise fully deductible by the IRA owner because a benefit was received by him from the charity (such as theater tickets for the contribution) then the *entire* transfer to the charity is includible in the IRA owner's gross income. In addition, the direct transfer from the IRA to the charity must be sufficiently substantiated by the IRA owner in order for it to qualify for the exclusion from gross income. The organization receiving the direct transfer must be a qualifying public charity. Transfers to private foundations, supporting organizations, donor-advised funds or split-interest trusts do not qualify. Therefore, such a direct transfer from an IRA to a charity during 2006 or 2007 should be subject to careful planning by the IRA owner and his or her tax advisor.