

entire amount of a distribution by a lower-tier CFC to an upper-tier CFC that gave rise (in whole or in part) to an adjustment to the U.S. shareholder's PTI accounts.

The new rules are proposed to apply to taxable years of foreign corporations beginning on or after final regulations are finalized and taxable years of U.S. shareholders with or within such taxable years.

SIGNIFICANT CHANGES AFFECTING EMPLOYEE BENEFITS

by David Pratt*

This Point to Remember summarizes significant recent employee benefits changes made by the Pension Protection Act of 2006 (PPA) and the Tax Relief and Health Care Act of 2006. Recent agency guidance is also included. Additional details about these changes appear in articles available at www.benefitslink.com.

PENSION PROTECTION ACT OF 2006

Pension Funding: The centerpiece of the PPA is a set of complex new rules that strengthen the minimum funding requirements for private sector defined benefit plans. Although the government's goal is to improve the funded status of these plans, critics fear that the additional funding requirements, coupled with new accounting requirements, are more likely to hasten the demise of private sector defined benefit plans.

EGTRRA Permanence: Section 811 of the PPA makes permanent the many pension changes included in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), including increased contribution and benefit limitations under section 415 and increased 401(k) deferrals under section 402(g).

Rollovers by Non-Spouses: Under prior law, a surviving spouse beneficiary could roll over benefits to

the spouse's IRA or another qualified plan. Non-spouse beneficiaries could not. Effective for distributions after December 31, 2006, section 829 of the PPA allows a non-spouse beneficiary to make a *direct transfer* (not a rollover) to an IRA from a qualified plan, a governmental section 457 plan, or a section 403(b) plan. Unlike spouses, non-spouse beneficiaries may move funds only to an IRA. *See also* Notice 2007-7, 2007-5 I.R.B. 395, Q & A 11 through 19.

Direct Rollovers to Roth IRAs: Effective for distributions *after 2007*, section 824 of the PPA allows a rollover directly from a qualified plan, section 403(b) plan, or governmental section 457 plan (but not from an IRA) to a Roth IRA. Previously, a rollover had to be made to a traditional IRA that was then converted into a Roth IRA. Such rollovers are subject to several rules, which also apply to conversions from traditional IRAs to Roth IRAs. First, the taxpayer must include the distribution in taxable income (except for after-tax funds). Second, the conversion is not subject to the 10 percent early withdrawal tax. Third, for 2008 and 2009, only a taxpayer with adjusted gross income of \$100,000 or less is eligible. (The Tax Increase Prevention and Reconciliation Act of 2005 eliminates the \$100,000 limit after 2009.)

Rollovers of After-Tax Amounts: Previously, after-tax amounts could be rolled over directly from a qualified plan to another qualified plan, or from a section 403(b) plan to another section 403(b) plan, but could not be moved from a qualified plan to a section 403(b) plan, or vice-versa. Section 822 of the PPA permits direct rollovers of after-tax amounts from a qualified plan to a defined contribution plan, defined benefit plan, or tax-deferred annuity. The change does *not* allow after-tax funds to be rolled over from a section 403(b) plan to a qualified plan.

New Early Withdrawal Exceptions: Section 72(t) imposes an additional income tax on most dis-

tributions made by a tax-favored retirement arrangement before the beneficiary reaches age 59 1/2. This rule had numerous exceptions under prior law. Section 828 of the PPA adds new exceptions for (1) any qualified reservist distribution and (2) distributions from a governmental defined benefit plan to a public safety employee, after separation from service after the attainment of age 50. *See* Notice 2007-7, *supra*, Q & A 6 through 10.

Automatic Enrollment Arrangements: Section 902 of the PPA includes provisions to encourage automatic enrollment programs, generally effective for plan years beginning *after* December 31, 2007.

Distributions to Charity: Section 1201 of the PPA provides an exclusion from gross income for certain distributions in 2006 and 2007 from a traditional IRA or Roth IRA (but not a SIMPLE IRA or SEP) that are paid *directly* by the IRA to a charity. Several limitations apply. The taxpayer must be at least 70 1/2; the exclusion is limited to \$100,000 per taxpayer per year; and the exclusion applies only if the entire charitable distribution would be deductible, without taking into account the percentage limitations based on adjusted gross income.

Amounts donated to charity count as minimum required distributions, but these excluded distributions are not deductible under section 170. Certain organizations are not eligible to receive excludible distributions. These include donor advised funds and certain private foundations. The Service has issued a procedure for changing a charity's classification to allow it to become eligible. *See* Ann. 2006-93, 2006-48 I.R.B. 1017. *See also* Notice 2007-7, *supra*, Q & A 34 through 44.

The Saver's Credit: Sections 812 and 833(a) of the PPA make the credit permanent and provide that the income limits will be indexed for inflation.

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Accelerated Vesting: Section 904 of the PPA subjects all employer contributions to covered defined contribution plans to the same vesting requirements as previously applied to matching contributions: either a three-year cliff schedule or a six-year graded schedule, beginning with 20 percent vesting after two years of service. *See also* Notice 2007-7, *supra*, Q & A 28 through 30.

ERISA Section 404(c): Section 404(c) protects fiduciaries of retirement plans against liability for the consequences of investment choices made by plan participants, provided that the requirements of the Department of Labor (DOL) regulations are satisfied. Section 624 of the PPA amends ERISA section 404(c) to provide that participants who fail to make an affirmative investment election will be treated as exercising control over their accounts if certain requirements are met. DOL has issued proposed regulations (71 Fed. Reg. 56805 (2006)) that do not provide for pre-effective-date reliance.

Section 621 of the PPA provides additional relief relating to blackout periods and mapping.

ERISA Preemption: Effective August 17, 2006, any state law restricting an “automatic contribution arrangement” will be preempted. The DOL is authorized to prescribe minimum standards. This new rule is not applicable to (1) plans that are not subject to ERISA or (2) plans that provide for automatic enrollment but do not satisfy the requirements for an “automatic contribution arrangement.”

Missing Participants: Section 410 of the PPA permits plan administrators of certain defined contribution plans to use the PBGC missing participant program upon plan termination.

Prohibited Transactions: Section 601 of the PPA adds a new exemption for advice provided to participants and IRA owners by a “fiduciary advisor” after December 31, 2006. The exemption is subject to conditions. Sections 611 and 612 modify the provisions to allow more flexibility with respect to invest-

ments, and provide a correction period for certain transactions involving securities and commodities.

Benefit Statements: Section 508 of the PPA amends ERISA to require plan administrators to provide benefits statements to each participant and specifies the information to be included. DOL has issued guidance on the new requirements. *See* Field Assistance Bulletin No. 2006-03, available at http://www.dol.gov/ebsa/regs/fab_2006-3.html.

Form 5500: Section 1103 of the PPA directs Treasury and DOL to simplify the Form 5500 annual reporting rules for plans with fewer than 25 participants and to exempt one-participant plans with less than \$250,000 in assets from filing. These changes would generally be effective for years beginning on or after January 1, 2007. *See also* 71 Fed. Reg. 71562 (2006).

EPCRS: Section 1101 of the PPA clarifies that the IRS has the authority to establish and improve the Employee Plans Compliance Resolution System and to waive income, excise, or other taxes to ensure that such penalties bear a reasonable relationship to the failure.

Governmental Plans: Section 861 of the PPA amends the Code to provide that, effective August 17, 2006, all governmental plans will be exempt from the qualified plan non-discrimination and minimum participation rules. Section 823 directs Treasury to issue regulations providing that a governmental plan is treated as complying with the minimum distribution rules if it complies with a reasonable, good faith interpretation of those requirements.

Hybrid Plans: Section 701 of the PPA amends ERISA, the Code, and the Age Discrimination in Employment Act to provide that a cash balance, or other hybrid, defined benefit plan, will not fail to qualify, and will not violate the age discrimination laws, if certain requirements are satisfied. There are additional requirements for traditional defined benefit plans that are converted into cash balance plans. The relief is pro-

spective only, and is generally effective for periods beginning after June 28, 2005. The Service has lifted the moratorium on issuing determination letters and has issued transitional guidance on newly converted cash balance plans. Notice 2007-6, 2007-3 I.R.B. 272.

DB/K Plans: Section 903 of the PPA provides for a new hybrid plan, a combination of a defined benefit plan and a 401(k) plan. The rules are generally effective for contributions for plan years beginning after 2006.

Section 409A: The Service has extended through December 31, 2007, most of the transition relief that applied in 2006 (Notice 2006-79, 2006-43 I.R.B. 763), and has issued transitional guidance on withholding and reporting for 2005 and 2006 (Notice 2006-100, 2006-51 I.R.B. 1109).

Section 116 of the PPA amends section 409A by providing for current taxation of any amount transferred to a rabbi trust or similar arrangement, to pay deferred compensation of a “covered employee,” during any “restricted period” with respect to a single-employer defined benefit pension plan of the employer.

On July 31, 2006, the ABA Section of Taxation requested a postponement of the effective date of section 409A to consider narrowing its scope or repealing it. *See* Tax Notes Today, Aug. 1, 2006, available on LexisNexis at 2006 TNT 147-23.

Direct Deposit of Tax Refund: Effective for tax years beginning on or after January 1, 2007, section 830 of the PPA allows a taxpayer to elect that part or all of a tax refund be directly deposited into an IRA.

Other PPA Changes: The Act increases the maximum ERISA bond from \$500,000 to \$1 million for a plan that holds employer securities [section 622]; updates the deduction rules for a combination of DB and DC plans [section 803]; allows additional IRA payments in certain bankruptcy cases [section 831]; addresses the determination of average compensation for purposes of the Code section 415 limitations [section 832]; pro-

vides for inflation adjustments of gross income limitations on certain retirement savings incentives [section 833]; revises the notice requirements for plan distributions [section 1102; *see also* Notice 2007-7, *supra*, Q & A 31 through 33]; requires defined contribution plans that hold publicly traded employer securities (other than certain ESOPs) to allow participants to diversify their accounts [section 901; *see also* Notice 2006-107, 2006-51 I.R.B. 1114]; requires regulations on QDROs [section 1001]; requires an additional survivor annuity option [section 1004]; provides that there will be no reduction in unemployment compensation as a result of pension rollovers [section 1105]; allows distributions on account of the hardship of a beneficiary [section 826; *see also* Notice 2007-7, *supra*, Q & A 5]; allows an income tax exclusion for certain distributions used to pay health insurance premiums for eligible retired public safety officers [section 845; *see also* Notice 2007-7, Q & A 20 through 27]; provides new

tax benefits for long term care insurance [section 844]; and includes new restrictions on corporate-owned life insurance [section 863].

Plan Amendments: In general, section 1107 of the PPA requires plans to be amended by the last day of the first plan year beginning on or after January 1, 2009, to effectuate the changes made by the Act. Governmental plans have until 2011 to make these amendments.

TAX RELIEF AND HEALTH CARE ACT OF 2006

On December 20, 2006, President Bush signed the Tax Relief and Health Care Act of 2006. Title III of Division A of the Act, sections 301 through 307, contains provisions relating to Health Savings Accounts (HSAs). These provisions are summarized below.

Rollovers: Rollovers may be made into HSAs from flexible spending accounts (FSAs) and health reim-

bursement arrangements (HRAs). This opportunity is available through 2011.

Contribution Limits: The maximum annual HSA contribution for 2007 is \$2,850 for an individual with self-only coverage and \$5,650 for an individual with family coverage, even if this exceeds the applicable deductible. For a newly eligible individual, the annual maximum need no longer be prorated for the number of months of participation in the initial year. The dollar amounts will be indexed for inflation.

Other Changes: Certain FSA coverage is disregarded in determining the allowable HSA contribution; the Act allows a one-time trustee-to-trustee transfer from an IRA to an HSA; and the Act modifies the comparability rules to allow greater employer contributions for non-highly compensated employees. ■

2006 LAW STUDENT TAX CHALLENGE WINNERS

The Tax Section congratulates the Young Lawyers Forum and the participants in the 2006 Law Student Tax Challenge competition. The top six J.D. teams and the top four LL.M. teams traveled to Florida to compete in the oral rounds at the Section's Midyear Meeting, and the following winners and their coaches were honored at a reception during the meeting.

J.D. DIVISION:

- **1st Place:** Jason Maus and Julie Ann Camden, Michigan State University Law School; Michelle LaForest Halloran, coach.

- **2nd Place:** Sarah Pendergraft and Jason McIntosh, University of Virginia School of Law; Michael Doran, coach.
- **3rd Place:** Jody Beilke and Martha Krohe, Northern Illinois University College of Law; Dan Schneider, coach.
- **Best Written Submission:** Joseph Myszka and Bonnie Wright, Santa Clara University School of Law; Jack Bogdanski, coach.

LL.M. DIVISION:

- **1st Place:** Matt McNeill and Stacey Olson, Loyola Law School; Jennifer Kowal, coach.

- **2nd Place:** Megan Stombeck and James Saling, Georgetown University Law Center.
- **Best Written Submission:** Matt McNeill and Stacey Olson, Loyola Law School; Jennifer Kowal, coach.

The Law Student Tax Challenge (LSTC) is a national tax planning competition sponsored by the Section's Young Lawyers Forum and is designed to reflect everyday tax practice more accurately than traditional moot court competitions. In the competition's six year history, the LSTC has become one of the largest tax competitions for law students in the United States. For more information about this program, go to: www.abanet.org/tax/lstc.