



**UNDERSTANDING THE  
PENSION PROTECTION  
ACT OF 2006**

What the changes mean to you



FINANCIAL SERVICES  
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This booklet provides an overview of the main provisions addressed by the Pension Protection Act of 2006 and how the changes can help you plan for your retirement.

The recently enacted Pension Protection Act of 2006 was created to help protect pension and retirement plan participants and promote individual savings. The legislation is aimed at restoring stability to traditional pension plans and makes permanent some of the provisions from the Economic Growth and Tax Relief Reconciliation Act of 2001 that enhanced retirement and educational savings options.

The sweeping pension reform, which introduces the most extensive revision of pension law in over three decades, allows you to take greater control of your financial security. We encourage you to take advantage of the savings opportunities extended by the 2006 Act and the new provisions created.

# **A GUIDE TO THE KEY PROVISIONS OF THE PENSION PROTECTION ACT OF 2006**

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## **THE 2006 ACT**

The comprehensive new legislation focuses heavily on defined benefit reform; however, we will examine the provisions of the 2006 Act that will have the greatest impact on owners of defined contribution retirement plans, IRAs and Section 529 College Savings Plans. Probably the best news for defined contribution plans is the repeal of the so-called “sunset provision” in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).

## **EGTRRA PERMANENCE**

The Economic Growth and Tax Relief Reconciliation Act of 2001 broadened a variety of the features of employer-sponsored retirement plans, IRAs and Section 529 plans. For example, it:

- raised contribution limits for defined contribution plans and IRAs
- allowed rollovers among qualified plans (401(a) and 401(k) plans), 403(b) plans, public 457(b) plans, and IRAs for greater flexibility in consolidating retirement plan assets
- permitted 403(b) and 401(k) plans to start accepting Roth-style contributions
- permitted individuals age 50 and over to make additional catch-up contributions to retirement plans and IRAs
- eliminated the Maximum Exclusion Allowance (MEA) that complicated the calculation of the maximum you can contribute on a tax deferred basis in 403(b) plans
- created a Saver’s Credit that allowed taxpayers with adjusted gross incomes below \$25,000 (\$50,000 for married joint filers) to claim a tax credit for contributions of up to \$2,000 a year to a retirement plan or IRA and
- created tax-free withdrawals from Section 529 plans for qualified expenses

In the absence of new legislation, these provisions were set to expire, or sunset, at the end of 2010, which would have had a negative impact on savings opportunities. For example, under EGTRRA, in 2010 the 402(g) limit on elective deferrals to 403(b) or 401(k) plans would have been \$15,000 (plus any incremental cost-of-living adjustments that accrue after the \$15,000 level is attained in 2006). But in 2011, the sunset provision would have reduced the 402(g) limit to its 2001 level of \$10,500 (plus whatever incremental cost-of-living adjustments would have accrued under that limit if the EGTRRA provision had never gone into effect). The Saver's Credit was actually scheduled for an early sunset in 2007.

Because of the 2006 Act, the pension provisions set forth in EGTRRA will not sunset. Making permanent the contribution limit increases and other enhancements of the 2001 Act, brings great news to individuals saving for retirement.

For example:

- the 402(g) limit will be adjusted annually for inflation in \$500 increments beginning in 2007
- IRA contributions will be \$4,000 in 2007, \$5,000 in 2008, and adjusted for inflation after 2008
- Catch-up contributions for those age 50 or older will be \$1,000 for IRAs and \$5,000 for 403(b) and 401(k) plans
- IRA catch-up contribution limits, however, will not be adjusted for inflation
- 403(b) and 401(k) catch-up contributions will be adjusted in \$500 increments based on inflation.

## **IRA CHANGES**

Under current law, individuals with an adjusted gross income (AGI) above a specified amount are not permitted to make tax-deductible IRA contributions if they (or their spouse) participate in an employer-sponsored retirement plan.

The income limits for making deductible IRA contributions have gradually increased in recent years — for 2006, \$60,000 for individuals and \$85,000 for couples. The income limit for making contributions to Roth IRAs has remained at \$110,000 for single taxpayers (\$160,000 for couples) since 2002. The 2006 Act provides for cost-of-living adjustments for the AGI limits for deductible Traditional IRAs and Roth IRAs (in \$1,000 increments) starting in 2007.

The new law will also allow IRA owners who are age 70½ and over, to make tax-free distributions of up to \$100,000 directly to tax-exempt charities in 2006 and 2007.

As another incentive to save, individuals eligible under the income limits will be able to direct all or a portion of their federal tax refund to an IRA (up to the applicable limit) starting in 2007.

## **ROTH CONTRIBUTIONS**

The Act permanently extends the Roth 401(k) and 403(b) features that were introduced in 2006 and were scheduled to sunset in 2010. The provision allows employees to make Roth style after-tax contributions to an employer-sponsored retirement plan. Your contributions and any potential earnings are eligible for tax-free withdrawal, if the account is open for five years and you are at least 59½ years of age. Some employers were reluctant to amend their plans to offer Roth savings provisions because of the cost of amending their plans to provide for a type of contribution that would only be permitted for five years. However, by removing this “sunset” the new legislation might encourage employers to adopt the Roth provisions.

## **EXTENDED AND ENHANCED ROLLOVER RULES**

The 2006 Act extends and enhances many of the rollover provisions introduced by EGTRRA. The provisions that have been extended include:

- the ability to roll over pretax amounts among and between 403(b) plans, qualified plans, public 457(b) plans and IRAs, provided the plan receiving the funds agrees to accept the rollover contributions. The rollovers can be in the form of direct or indirect (60-day) rollovers.
- the ability to roll over after-tax amounts between plans of the same type (i.e., from a 403(b) plan to another 403(b) plan), or from a qualified defined contribution plan to another qualified defined contribution plan) by direct rollover only.
- the ability to roll over after-tax amounts from a 403(b) or qualified plan to an IRA by either direct or indirect rollover.

In addition, the 2006 Act enhanced some existing rollover provisions and introduced some new ones. As a result of this legislation:

- you will be able to convert retirement plan balances directly into a Roth IRA without first rolling over the funds into a Traditional IRA, starting in 2008. New legislation, separate from the 2006 Act, states that there will no longer be an income limitation for those interested in converting funds to a Roth IRA, starting in 2010.
- you will be able to roll over ordinary after-tax balances in any qualified retirement plan to any 403(b) or qualified plan (including defined benefit plans) that agrees to accept the funds and track them separately.
- Nonspouse beneficiaries will be able to roll over inherited 403(b), qualified, or public 457(b) accounts into their own IRA, beginning in 2007. The new IRA will be subject to the same rules as an IRA inherited by a nonspouse beneficiary. To

the extent provided by U.S. Treasury regulations, this will also apply to benefits payable to a trust maintained for a designated beneficiary. This will give nonspouse beneficiaries more flexibility in their retirement and estate planning.

### **INVESTMENT ADVICE**

The 2006 Act provides two new exemptions that allow companies to offer investment advice to participants in individually directed defined contribution plans or IRAs with respect to the their own or an affiliate's funds or contracts, as long as various requirements are met.

The requirements are intended to ensure that participants receive reliable guidance on selecting appropriate investments for their needs and goals. It is not yet clear how many companies will rely on these new exemptions or provide objective advice from an outside independent financial expert as permitted under current law.

### **NEW VESTING SCHEDULE**

EGTRRA required that employer matching contributions be 100% vested after completion of three years of service, or 20% vested each year beginning with the employee's second year of service and ending with 100% after six years of service. However, employers were allowed to retain a slower vesting schedule for their non-matching employer contributions. The new legislation requires employers to apply the faster schedule to all contributions in plan years beginning after December 31, 2006. The vesting period is the length of time you must work for an employer for you to take full ownership of the account.

### **BENEFIT STATEMENTS**

The new Act requires administrators of defined contribution plans to provide benefit statements to participants and beneficiaries at least quarterly in plan years beginning after December 31, 2006. The statements must include:

- the participant's balance in each account

or fund to which he or she has a current allocation,

- current vesting status,
- restrictions on investment allocations, if any, and
- a cautionary statement on the need to maintain a diversified and well-balanced portfolio.

### **IN-SERVICE DISTRIBUTIONS**

401(k) plans and other profit-sharing plans can allow in-service distributions, which are withdrawals from a retirement plan while you are an active employee. But in-service distributions generally are not permitted under federal law from defined benefit plans or money purchase plans until normal retirement age under the plan (generally age 65). Starting in 2007, these plans will be allowed to start permitting in-service withdrawals to participants who have attained age 62.

### **529 COLLEGE SAVINGS PLANS**

EGTRRA included a number of provisions that made Section 529 College Savings Plans more attractive, including one that allowed tax-free withdrawals for qualified expenses. It also authorized the creation of prepaid tuition programs and rollovers from one account to another every 12 months. All of these provisions were scheduled to expire at the end of 2010. Fortunately, the new Act eliminates the sunset and makes EGTRRA's 529 provisions permanent. This will make 529 plans more attractive to individuals who were concerned about the uncertainty of withdrawals being taxed on the federal level after 2010.

## **DEFINED BENEFIT PLANS**

In addition to the provisions that impact defined contribution plans, the 2006 Act significantly affects defined benefit plans. The legislation is designed to strengthen defined benefit plans and encourage employers to keep their plans solvent. The legislation modifies the rules for funding defined benefit plans, which will generally require employers to increase contributions to their pension arrangements.

Plans will be required to become fully funded over a seven-year period — meaning that employer pension contributions will be based on certain criteria that ensure plan assets are sufficient to satisfy future obligations.

Prior funding rules allowed too great a degree in contribution flexibility, which sometimes led to situations where plan assets were not sufficient enough to support the promised benefits.

The new law also identifies “at risk” plans and applies stricter funding requirements to help stabilize the plan and avoid a potential shortfall in assets if the plan terminates. Measurements and benchmarks were created to help identify when a plan is in trouble and what steps must be taken to return the plan to fiscal stability.

This will not only help to avoid a potential bailout at taxpayer expense, but also ensure benefits are available for current and future retirees. However, because of the increased contributions associated with the new provisions, the changes may accelerate the trend of corporations moving away from defined benefit plans to defined contribution plans in which the employee plays a greater role in funding and managing their retirement savings.

The new rules generally apply to plan years after 2007.

## **A FINAL WORD**

Please note that many of the provisions created in the Act will be subject to interpretation and potential adjustments as the legislation is put into practice.

If you have further questions about the Pension Protection Act of 2006, please contact us:

### **TELEPHONE COUNSELING CENTER**

**800 842-2776**

To speak with a consultant about how the changes may affect your savings strategies and additional information on your accounts. Monday to Friday from 8 a.m. to 10 p.m. and Saturday 9 a.m. to 6 p.m. (ET).

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