Legislative Updates

September 6, 2006

Pension Protection Act of 2006

On August 17, 2006 President Bush signed the Pension Protection Act of 2006 (PPA). Various provisions of this Act become effective as late as 2010 but one provision that is effective for plan years beginning after December 31, 2005, may benefit smaller companies with defined benefit plans.

Who Would Benefit?

If a larger deduction is desired, or if the owners of a company would like to have the opportunity to defer into a 401(k) plan or make a profit sharing contribution, this may be a great solution.

The History

Prior to PPA, the maximum deduction allowable under Internal Revenue Code Section 404 for a stand alone Defined Benefit plan was calculated without regard to compensation (i.e., the contribution could exceed the compensation). For a Defined Benefit/Profit Sharing plan combination the maximum deduction was the greater of 25% of compensation or the minimum required contribution for the defined benefit plan. Depending upon the demographics of a company, very often the Defined Benefit contribution was more than 25% of compensation, leaving no ability to make a deductible profit sharing plan contribution.

While 401(k) deferrals were allowed because they are not part of the deduction limit, rarely was it cost effective to have a separate plan solely for the purpose of deferring. In addition, correction methods were limited to refunds in the event of a test failure because any contribution made to correct a test would be non-deductible.

Now

Under PPA, the deduction limit for combination plans has changed to the <u>greater</u> of:

25% of compensation

OR

The <u>sum</u> of

- the maximum defined benefit contribution, <u>plus</u>
- 6% of compensation in the profit sharing plan

Again, deferrals and catch-up contributions are allowed because they don't count toward the deduction limit.

What Does This Mean?

This opens many possibilities. Depending upon the number of employees and the demographics of a company, several design elements could be considered such as adding:

- A 401(k) plan
- Catch-up provisions if there are participants age 50 or older
- A 3% Safe Harbor profit sharing contribution
- A 3% Safe Harbor profit sharing contribution with an additional 3% subject to a vesting schedule
- A tiered allocation with 3% Safe Harbor profit sharing contribution and an additional 3% to certain participants

Example:

For ease of understanding, we are showing how a one-person plan benefits from this new provision:

Owner >age 51 □ Compensation: $220,000 or higher

	Defined Benefit Plan Only	Under PPA 2006
Defined Benefit Plan	$148,036	$148,036
401(k) Deferral	$0	$15,000
Catch-up (age +50)	$0	$ 5,000
6% Profit Sharing Contribution	$0	$13,200
Total Contribution for the Year	**$148,036**	**$181,236**

What should I do?

If this is an opportunity you would like to explore, please call either your ACI plan administrator, Skylar Smith, Retirement Plans Consultant, or Tobi Cogswell, Director of Client Services. We welcome the chance to work with you.

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