ROBERTS & HOLLAND LLP

To Our Clients and Friends *October 11, 2006*

Provisions of the Pension Protection Act of 2006 Affecting Individual Taxpayers

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On August 17, 2006, President Bush signed the "Pension Protection Act of 2006" (the "Act") into law. Among the sweeping tax law changes made to retirement and health and welfare plans are a number of provisions of interest to individual taxpayers.

Tax-Deferred Distributions to Non-Spouse Beneficiaries

It is not unusual for an employer-sponsored retirement plan, such as a 401(k) or profit sharing plan, to require that, upon the death of the plan participant, the benefit payable to the survivor under the plan (for example, the balance in the 401(k) account) be paid to non-spouse beneficiaries in a lump sum. Although the payment can be delayed for up to five years, the full amount of the distribution is immediately taxable when paid.

By contrast, upon the death of an IRA owner, a non-spouse beneficiary may convert the IRA into an "inherited IRA," which will be subject to the required minimum distribution ("RMD") rules. In the case of a non-spouse beneficiary, RMDs from the inherited IRA, which must begin by December 31 of the year following the year of the deceased IRA owner's death, can be *based on the non-spouse beneficiary's life expectancy*. The effect of these rules is to minimize annual payments to the beneficiary while allowing assets to accumulate on a tax deferred basis.

After 2006, a non-spouse beneficiary of an employer-sponsored retirement plan cannot be compelled to accept a lump sum payment of the survivor benefit. Under the Act, the survivor benefit may be rolled over, in a direct trustee-to-trustee transfer, to an inherited IRA that will be subject to the inherited IRA rules described above.

Direct Rollovers from Retirement Plans to Roth IRAs

A participant in an employer-sponsored retirement plan who is entitled (under the plan) to receive a lump sum or other eligible distribution is permitted to roll over such distribution into a traditional IRA or another employer's retirement plan. Under the Act, after 2007, the participant will also have the option to rollover such a distribution into a Roth IRA.

The rollover into a Roth IRA is not tax-free. Generally, the rollover amount is includible in the participant's gross income, but the 10% early withdrawal penalty does not apply to the rollover amount, regardless of the participant's age.

A plan participant who wishes to roll over a distribution to a Roth IRA is subject to the same income limitations as the owner of a traditional IRA being converted into a Roth IRA. In 2008 and 2009, a participant may direct a rollover into a Roth IRA only if the participant's "modified adjusted gross income" is $100,000 or less. In addition, no rollover to a Roth IRA is permitted if the participant is married and files a separate return. In 2010 and later, under a change in the law that was enacted this past May as part of the Tax Increase Prevention and Reconciliation Act of 2005, both the $100,000 "modified adjusted gross income" limit and the filing status restriction are eliminated for the conversion of a traditional IRA into a Roth IRA and are likewise eliminated for a direct rollover into a Roth IRA from an employer-sponsored retirement plan.

Indexing the Roth IRA Income Limit

The maximum amount an individual may contribute to a Roth IRA ($4,000 in 2006 and $5,000 for individuals age 50 or more in 2006) is subject to reduction based on the individual's filing status and modified adjusted gross income. For a single taxpayer, phase out occurs when modified adjusted gross income is between $95,000 and $110,000; for married taxpayers filing joint returns the phase out range is $150,000 to $160,000; and for married taxpayers filing separate returns the phase out range is $0 to $10,000.

Under the Act, starting with the 2007 tax year, the phase out ranges will be indexed for inflation (increases will be in multiples of $1,000).

Tax-Free IRA Distributions to Charities

In a long-anticipated change, the Act allows an individual aged 70½ or older to contribute up to $100,000 per year from traditional or Roth IRAs to most public charities and private operating foundations without recognizing income, but only in 2006 and 2007. The contribution must be made directly from the IRA to the charity. Qualified charitable entities include all public charities other than supporting organizations and donor advised funds, plus private operating foundations. The taxpayer neither recognizes income nor enjoys a charitable deduction for the contribution. Further, the distribution is not counted against the taxpayer's 50 percent of adjusted gross income limit on contributions to charity, but does count as part of the taxpayer's RMD.

If you have any questions or would like further information about the matters discussed above, please call Norman J. Misher at (212) 903-8733, Quincy Cotton at (212) 903-8739, JoAnn Luehring at (212) 903-8731, Allen J. Erreich at (212) 903-8769, or any of our other attorneys.

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