

The Loomis Law Update

Recent Employee Benefits Developments

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Pension Protection Act Ushers in Many Changes for Retirement Plans

The Pension Protection Act of 2006 ("PPA"), one of the most significant pieces of pension legislation enacted in recent years, importantly changes the laws regulating retirement plans. This article will highlight some of those changes.

The PPA requires that defined benefit plans meet certain minimum funding standards, based on far more limited actuarial assumptions than previously allowed. This means that some employers will be faced with substantial funding payments soon. The change is designed to prevent future problems with pension funding obligations and to reduce the possibility of bailouts paid for by the federal Pension Benefit Guaranty Corporation ("PBGC").

The PPA also has made many of the changes in the law created by the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") permanent. The Roth 401(k) option, previously scheduled to expire in 2010, now has no expiration date. Also, higher annual salary deferral amounts and catch-up contributions for those over age 50 to 401(k) plans have been made permanent as well.

Automatic enrollment in 401(k) plans has been made more attractive by new safe harbors for nondiscrimination testing for elective deferrals and for matching contributions. This allows employers to enhance the saving opportunities for their employees and

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Estate Planning Possibilities For Tax Savings Under the Pension Protection Act

Non-spouse beneficiaries may now roll over distributions from qualified plans into Individual Retirement Arrangements ("IRAs") under the new Pension Protection Act of 2006 ("PPA"). This change in the law may have a profound impact on the estate planning options available to participants and could create significant tax savings for beneficiaries.

All participants of qualified plans should have their estate plans reviewed in light of the new rules of the PPA. Where appropriate, taking advantage of these rules may allow for significant tax savings.

At the death of a plan participant, only the surviving spouse would be allowed to roll over a lump sum distribution into an inherited IRA and defer taxation. All other non-spouse designated beneficiaries incurred taxes for the year in which the lump sum was paid,

receiving the distribution from the plan on behalf of the designated beneficiary. The non-spouse is then bound by the required minimum distribution (RMD) rules for an inherited IRA, meaning either: 1) if the participant's RMD had begun before his or her death, the remaining portion must be distributed from the IRA at least as quickly as it was being distributed before the

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A brief summary of the rules before the PPA and the rules under the PPA show the changes.

Pre-PPA Rules

Under the old law, after the

PPA Rules

Under the new law, a non-spouse beneficiary can roll the lump sum distribution into an inherited IRA by means of a direct trustee-to-trustee transfer. The inherited IRA is established for the purpose of re-

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Medicare Notices of Creditable Coverage Must Be Provided by November 14

Plan administrators of prescription drug plans are reminded that annual Notices of whether the plan provides "creditable coverage" or "non-creditable coverage" must be sent to affected persons by November 14, 2006.

The law requires drug plans to provide individuals with notices indicating whether or not coverage under the plan is "creditable" so that such persons know if they will be affected by an increased premium if they become covered under Part D.

If an individual does not enroll in Part D of Medicare for prescription coverage when first eligible for coverage, then he or she will have to pay a permanently increased premium if they enroll at a later time. The premium increase is waived, however, if an individual has "creditable coverage" for prescription drugs under another plan if the individual enrolls later in Part D.

Determination of "creditable" status

Coverage is considered "creditable" if its actuarial value equals or exceeds the actuarial

value of standard prescription drug coverage under the Medicare prescription drug program. The actuarial equivalence test measures whether the expected amount of paid claims under the plan's prescription drug coverage is at least equal to the expected amount of paid claims under standard prescription drug coverage under Medicare. Such test is usually determined by an actuary.

CMS has an alternative simplified determination method in place for determining whether coverage is creditable. If a plan meets all of the criteria under the simplified method, then it is not necessary to hire an actuary to make a determination.

Under the simplified method, the prescription drug plan is deemed creditable if it:

1. provides coverage for brand and generic prescription;
2. provides reasonable access to retail providers and, optionally, for mail order coverage;
3. is designed to pay on average at least 60% of participants' prescription drug expenses;

and 4. satisfies at least one of the following:

[Note (a) and (b) may be used only if prescription drug benefits are not integrated with benefits other than prescription drug coverage, such as medical, dental, etc. Integrated plans must use (c) below.]

(a) The prescription drug coverage has no annual benefit maximum benefit or a maximum annual benefit payable by the plan of at least \$25,000, or

(b) The prescription drug coverage has an actuarial expectation that the amount payable by the plan will be at least \$2,000 annually per Medicare-eligible individual.

(c) The integrated health plan has no more than a \$250 deductible per year, has no annual benefit maximum or a maximum annual benefit payable by the plan of at least \$25,000, and has no less than a \$1 million lifetime combined benefit maximum.

The simplified determination method is not available to entities which are applying for a retiree

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PLANNING: PPA Creates Tax-Saving Opportunities for Distributions from Plans

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lowing the year of the participant's death, or 2) if the participant died before the beginning date for RMDs, the entire interest must be distributed either: a) within five years of the participant's death, or b) over the life expectancy of the oldest designated beneficiary with payments beginning in the year fol-

lowing the year of the participant's death. This change is significant because it allows for participants who die before RMDs begin to name young designated beneficiaries (such as children or grandchildren), and potentially stretch out the distributions from the IRA by decades, reducing the

amount of the taxable yearly distribution. Even if RMD distributions have begun, the beneficiary will still receive a tax benefit by being able to receive the distributions over the time period the participant would have received them, instead of paying taxes on a lump sum distribution.

These new rules may be used to the advantage of plan participants in the estate planning process. Where appropriate, taking advantage of these rules may allow for significant tax savings. Plan participants should have their estate plans reviewed to identify possible tax saving strategies.

PPA: New Rules Encourage Phased Retirement And Charitable Contributions

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reduce expenses related to testing of 401(k) contributions at the same time. Employers still must allow their employees to opt out of automatic 401(k) enrollment. To meet the safe harbor for the elective deferral test, at least 3% of an employee's compensation must be automatically deferred, increasing one percentage point each year until the fourth year the employee is in the plan, and the automatic deferral is 6% of compensation. The safe harbor for the matching contribution is met if the employer contributes either (1) 3% of each non-highly compensated employee's compensation or (2) an amount equal to each non-highly compensated employee's contributions if contributions are 1% or less of compensation, plus 50% of contributions that exceed 1% but not more than 6% of compensation.

Also new under the PPA are mandatory participant disclosure rules. For defined contribution plans, a quarterly statement must be given to participants who direct their investments but, for plans which don't allow for participant direction, the statement need only

be given annually. Defined benefit plans have a lesser requirement of once every three years (unless a participant asks for more frequent statements).

For 2006 and 2007 only, the PPA allows taxpayers who have reached age 70 1/2 and must take a minimum required distribution to make contributions to charities from distributions of their IRAs while excluding the distributions from their income. Such distributions are limited to less than \$100,000 and must be paid directly to the charity(ies). While no charitable contribution deduction is available for donations made under this rule, this may be a useful tool for someone looking to minimize the tax impact of required minimum distributions.

Employees who are age 62 and over may also receive in-service distributions under the PPA. This allows employees age 62 and older to continue working for their employers at reduced hours while in-service distributions keep their income level at approximately the same amount. This concept, sometimes referred to as "phased retirement," will be available for plan years beginning after December 31, 2006.

PART D: Rules Relating to Providing Annual Notices

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drug subsidy.

Timing

At a minimum, notices must be provided:

(a) prior to an individual's initial enrollment period for Part D coverage;

(b) prior to the effective date of enrollment for coverage in the drug plan and upon any change affecting creditable status;

(c) prior to November 15 of each year, the annual coordinated election period;

(d) upon request of beneficiary.

Notices

The Centers for

Medicare and Medicaid Services (CMS) has provided Model Notices, available at the CMS website

(<http://www.cms.hhs.gov/v/creditablecoverage>).

There are three different versions on the website: a model notice if the plan provides creditable coverage; a model notice if the plan does not provide creditable coverage; and a personalized notice. A plan administrator may download one of these forms and adapt it for use. Plans may also design their own forms, as long as they satisfy the notice requirements.

The Notice must be sent to Medicare-eligible participants and beneficiaries covered by the drug plan before November 15 of each year.

Disclosure to CMS

Prescription drug plan administrators should keep in mind that each plan is to file a disclosure form with CMS confirming that notices were provided to affected individuals within 60 days after the beginning of the plan year. This disclosure is done on-line, and the form may be found at the CMS website (<http://www.cms.hhs.gov/v/CreditableCoverage>).

409A Effective Date Delayed Until 2008

Employers with deferred compensation plans have an additional year before they have to comply with complicated regulations after the Internal Revenue Service recently announced that it delayed the effective date of regulations under section 409A of the Internal Revenue Code. The regulations will be effective on January 1, 2008, pushed back from the original date of January 1, 2007. Although the effective date has been postponed, all plans subject to 409A must be operated in good faith compliance with the statute.



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