

Highlights of The Pension Protection Act of 2006

While the primary focus of the *Pension Protection Act of 2006* is to increase the security and enhance the viability of both the private pension system and the federal pension insurance system, there are a number of provisions that relate to IRAs and other qualified and non-qualified retirement programs, as well as insurance products generally. Here is a high-level summary of the most important of those provisions.

1. The provisions of EGTRRA pertaining to pension contributions and benefit limits, including those pertaining to IRAs, Roth IRAs, and TSAs, become permanent. So, too, are the catch-up provisions of EGTRRA.
2. Direct rollovers from qualified plans to Roth IRAs (without going through a traditional IRA first) will be permitted for distributions after December 31, 2007.
3. Beginning with distributions made in 2007 (**and not before!!**), **non-spouse beneficiaries** may make trustee-to-trustee transfers/direct rollovers of their interests in an IRA or qualified plan to an IRA. The transferee/rollover IRA will be treated as an inherited IRA and subject to the normal required minimum distribution rules that pertain to inherited IRAs. But, the biggest advantage is that non-spouse beneficiaries will be able to take life expectancy/life payouts rather than plan-mandated payouts within a year or 5 years (however the plan provision reads).
4. Taxpayers, beginning with the 2007 tax forms, will be able to elect to have their tax refunds paid directly into their IRAs.
5. For tax years 2006 and 2007, taxpayers may make tax-free distributions from their IRAs to tax-exempt charities up to a cap of \$100,000 a year. The amount will be excluded from income and will not impact the normal charitable deductions otherwise available to the taxpayer in the same year.
6. If a company's current defined benefit pension plan is "at-risk" or the company is in bankruptcy and a non-qualified deferred compensation plan exists, any amounts set aside for executives and other highly compensated individuals will be immediately taxable to them and subject to an additional 20% tax, as well as interest from the initial date of deferral or deemed deferral. This provision also applies to rabbi trust arrangements and is designed to prohibit the top execs from benefiting economically while rank and file employees suffer.
7. IOLI/SOLI/STOLI is not specifically addressed in terms of imposing any sanctions on such transactions, but Treasury is charged with studying the impact of these programs with respect to charities that acquire an interest directly or indirectly in insurance, endowment, and annuity contracts in which charities and private investors share an interest. Charities will have to file annual information returns to disclose these transactions. Specifically exempted from the requirements are transactions in which the party providing the financing has an insurable interest in the insured or where the only interest of the parties to

the contract (other than the insured) is as a named beneficiary. Certain exemptions will also apply to fiduciary transactions, such as certain trust arrangements.

8. Qualified LTC insurance/non-qualified annuity combination contracts will be blessed by the Tax Code beginning in 2010. Moreover, QLTCI/non-qualified life insurance combinations will be enhanced under the Code. In essence, deemed distributions taken from the underlying insurance or annuity contract's account value to pay for included LTC benefit coverage provided within the contract or by rider will be excluded from income, even if the distribution is deemed to come from contract earnings. Distributions to pay for QLTCI coverage will reduce basis in the underlying contract, but not below zero (\$0). Further distributions beyond this floor beginning in 2010 will NOT be includible in income. As a corollary, no deduction under Code section 213 for medical expenses in excess of 7.5% of adjusted gross income will be permitted. This same rule exists today.
9. Beginning in 2010, tax-free exchanges under Code section 1035 will be permitted so that an existing life insurance, annuity, or endowment contract may be exchanged for a QLTCI contract without incurring any tax on the accumulated gain. A QLTCI contract may also be exchanged tax-free for another QLTCI contract. Moreover, tax-free exchanges among life insurance and annuity contracts that are permitted under current law would not be disallowed by reason of a life insurance or annuity contract including a QLTCI rider or benefit provision. It remains to be seen whether this means you could exchange a life or annuity policy with a QLTCI rider/benefit for one without it, but you certainly will be able to go the other direction. Since the provision is designed to enhance the sale and purchase of QLTCI, it is not unreasonable to believe that *dropping* the rider/benefit in an exchange might not be a permissible 1035 exchange.
10. BOLI/COLI provisions were also included in PPA 2006. After much negotiation and consternation, a set of new rules which will ***tax policy proceeds in excess of what is paid for the policy by the business owning it unless certain basic requirements are met*** have been put in place. These new rules are effective AFTER the date of enactment of PPA 2006. In other words, by the time you read this, the new rules are already in play. Here are the minimum requirements you MUST follow if you want to assure that policy proceeds received by a business will continue to be income tax-free.
 - **BEFORE** the issuance of a BOLI/COLI policy,
 - a. The employee must be **notified in writing** that:
 - i. The employer intends to insure the employee's life. The notice must state the **maximum** face amount for which the employee could be insured at the time the contract is issued (the maximum amount that might be applied for), and
 - ii. The employer will be a beneficiary of any death benefits

- b. The employee must provide the employer with **written consent** acknowledging that
 - i. The employee is being insured, and
 - ii. The employer may continue the coverage after the employee terminates employment
 - If all the above requirements are met, you're still not out of the woods unless you also meet one or more of the following requirements:
 - a. The insured must have been an employee at any time during the 12-month period before his/her death
 - b. At the time the policy was issued, the insured was a director or highly compensated employee (as defined under the qualified plan rules) or a highly compensated individual (among the highest paid 35% of all employees)
 - c. The death benefits are paid to the insured's family, a designated beneficiary under the contract (other than the employer), a trust for any such person, or the insured's estate
 - d. The death benefits are used to purchase an interest in the employer from any of the parties named in "c" above
11. To assure compliance with the new BOLI/COLI rules, employers will have to file information returns annually disclosing the existence and extent of any such plans they sponsor. As part of the information return, the employer will acknowledge, likely under penalty of perjury, that the employer has valid consents on file for each insured employee as well as the number of employees for whom consent was not obtained.
12. 1035 exchanges of BOLI/COLI policies will generally not cause an employer automatically to come under these new rules, but if the new policy is materially changed from the one being exchanged, grandfathering may be lost. Elective material increases in death benefits are mentioned as one change that will cause a loss of grandfathering and a requirement to comply with the new BOLI/COLI notice and consent rules.

Clearly, the new notice and consent rules for BOLI/COLI present some immediate problems for employers, employees and advisors. Since the provision was drafted so broadly as to include basically any employer-owned insurance contract (other than those funding a qualified retirement or annuity plan), it is advisable to assure that the notice and consent requirements are met **BEFORE YOU SUBMIT A CASE TO UNDERWRITING**. While we and other companies will be working on forms available for you to provide to an employer to help that employer meet its responsibilities under the new law, here is a template that might help in the interim.

[SPECIMEN FORM]**EMPLOYER NOTICE AND EMPLOYEE CONSENT TO BE INSURED**

(A copy is to be retained by both Employer and Employee, and a copy furnished to the Insurer)

_____, hereafter referred to as "Employer" , hereby gives notice to _____, hereafter referred to as "Employee", that Employer intends to insure the life of the Employee in an amount not to exceed \$_____, that the Employer will be the named beneficiary of the policy's death benefits, and that the Employer may, in its sole discretion, continue the insurance policy in force beyond such time as the Employee terminates employment with the Employer.

Employee hereby acknowledges receipt of the above notice and gives consent to being insured under a policy to be owned by Employer. Employee further acknowledges that the policy may be continued in force by the Employer after the time the Employee no longer is employed by the Employer.

Attested and agreed to by:

Employer

Employee

Date: _____

Please be aware: There appear to be no methods of "fixing" a failure to comply with the new notice and consent requirements. You MUST comply and you must do so BEFORE the policy on the employee's life is issued!!

The Estate Tax Issue

Now, a word on the Estate Tax. As you have read in the press, the most recent estate tax reform proposal failed in the Senate by a 56-42 vote. The vote was actually 57-41, but the Senate Majority Leader changed his vote to the negative in order procedurally to be able to resurrect the bill for further consideration without advance notice. Thus, it behooves us all to pay close attention to Congress after it returns from the August recess to see whether the bill as passed in the House gets voted on once again in the Senate.

Most commentators feel that the opposition to the most current reform effort will not abate even after the recess because of the pure cost of the proposal...nearly 80% of outright repeal. Ultimately, it is thought a compromise may be achievable if the proposed tax rates are raised to something more in line with where they'll otherwise be in 2009, with an equivalent exemption in the neighborhood of \$3.5-5 million, perhaps with the portable unified credit provision that is contained in the bill passed by the House and defeated by the Senate before its August adjournment. But the timing of any compromise is uncertain. Equivalent repeal is clearly a goal of the Bush Administration and the Republican controlled Congress. If it fails again in the Senate, compromise in reduced fashion may be unlikely because of the pressures of this being an election year. Less costly reform may well be more achievable in 2007, after the elections, especially if some of the predicted losses of Republican Senate seats in fact occur. Time will tell. Stay vigilant and stay tuned!

Good Selling!



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