



Molly J. McCarragher, JD

# Pension Protection Act benefits individual employees

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The Pension Protection Act (PPA) of 2006 has been billed as the most comprehensive pension reform package in 30 years. The act is designed to provide or strengthen safeguards for employee pensions and provide relief to airlines. However, the act includes many provisions unrelated to pension plans that could benefit individual employees.

## **“Designated Beneficiary” Extends to Non-spouses**

Prior to 2007, the law allowed a spouse to rollover a qualified retirement plan (such as 401(k), defined benefit, and pension plans) or IRA benefits into his or her own IRA, remain the beneficiary of the plan or IRA, or transfer the benefits to an inherited IRA in the decedent’s name. Effective January 1, 2007, a “designated beneficiary” may rollover a distribution from an “eligible retirement plan” received upon the death of the employee owner.

A designated beneficiary could be a domestic partner, child, or other relative who now may rollover distributions without losing the tax-deferral benefits of the plan. Both married and unmarried employees benefit from the additional estate planning opportunities this significant change in the law presents. For example, married couples

in which both spouses have large estates now may pass the retirement asset directly to children or grandchildren.

The PPA also protects the tax deferral benefits of inherited retirement plans. While the previous law allowed an individual beneficiary of an IRA or qualified plan to take distributions over his or her life expectancy, the reality is that many qualified plans do not allow the beneficiary of an inherited plan to “stretch out” receipt of the inheritance over the beneficiary’s life expectancy. Most plans require that the retirement benefits be paid to the beneficiary in a lump sum or within 5 years of the participant’s death. As a result, the qualified plan benefits were subject to income taxes at an accelerated rate and the tax deferral of the plan assets was lost.

Under the new law, the distribution must occur as a direct trustee-to-trustee transfer into an IRA or individual retirement annuity. The IRA is then treated as an inherited IRA/individual retirement annuity and the payments may be distributed over the life expectancy of the beneficiary, allowing for extended income tax deferral.

## **IRA Distributions Direct to Charities**

Prior to the PPA, upon reaching 70 ½, traditional IRA owners had to begin taking their required minimum distributions (RMD) from their IRA. The IRA owner could then make a charitable contribution in an amount equal to the required distribution. The IRA owner recognized the income associated with the distribution and would be entitled to a charitable income tax deduction. In practice, the additional

tax associated with the recognition of the income often exceeded the extra deduction due to the itemized deduction phase-out limits for high income earners and charitable contribution deduction limits.

While the PPA does not eliminate the RMD requirement, the act allows IRA owners age 70 ½ or older to transfer up to \$100,000 per year directly from their IRAs to qualified public charities. This direct transfer does not result in the IRA owner recognizing the income or taking a charitable deduction. In addition, the direct transfer to charity will count toward the IRA owner’s RMD. The rule applies only to gifts made during life (not to bequests made upon death) and is only effective for 2006 and 2007. Whether or not the provision will be extended beyond 2007 is unknown.

The changes provided by the PPA may be particularly beneficial to participants who are required to take their RMDs but who do not need or desire the additional income. Also, the change may benefit participants who do not itemize their income tax deductions, either because they claim the standard deduction or they reside in a state that does not have a state income tax, such as Florida. The change would also benefit participants whose taxable income would be high enough to cause itemized deductions to be phased out or whose gifts to charity would otherwise be subject to the 50% annual charitable deduction limitation.

These are 2 of the more notable provisions affecting individuals that were included within the over 900-page text of the PPA. For more information, please contact your financial adviser.

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Molly J. McCarragher, JD, is a relationship manager with SVA Wealth Management, Inc. SVA Wealth Management, formerly known as SVA Planners, Inc., is the registered investment adviser affiliated with Suby, Von Haden & Associates, S.C. For more information, contact Wisconsin Medical Society Insurance and Financial Services, Inc., at 866.442.3810.

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