

NORMAL RETIREMENT AGE ISSUES FOR GOVERNMENTAL PENSION PLANS

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Normal Retirement Age Regulations

On May 22, 2007, the IRS issued final regulations (Treasury Regulation §1.401-1) clarifying that a pension plan (a defined benefit plan or money purchase pension plan established under Internal Revenue Code Section 401(a)) may be designed to allow the payment of benefits when an employee reaches normal retirement age but hasn't yet terminated employment. The final regulations establish the following standard for defining normal retirement age: "the normal retirement age under a plan must be an age that is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed."

The final regulations then address three age ranges. First, the regulations provide a "safe harbor" for a plan with a normal retirement age of age 62 or older, which is deemed to be not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed. Second, the regulations provide that if a pension plan's normal retirement age is earlier than age 62, but not earlier than age 55, the IRS will examine all of the relevant facts and circumstances to determine whether the normal retirement age satisfies the standard. Generally, the IRS will give deference to an employer's reasonable determination that a normal retirement age between 55 and 62 satisfies the standards in the final regulations. Finally, if the plan's normal retirement age is lower than age 55, the age is presumed to be earlier than the standard established in the final regulations.

The final regulations also provide a special rule for pension plans in which substantially all of the participants are "qualified public safety employees." In such plans, a normal retirement age of age 50 or later will be considered to satisfy the standard established by the final regulations. A "qualified public safety employee" means "any employee of a State or political subdivision of a State who provides police protection, firefighting services, or emergency medical services for any area within the jurisdiction of such State or political subdivision."

The final regulations are generally applicable May 22, 2007. However, for governmental plans, the IRS has extended the effective date of the regulations to plan years beginning on or after January 1, 2011.

IRS Notice 2007-69

The final regulations resulted in a number of concerns about how to apply the regulations by the deadline. In response, the IRS issued Notice 2007-69, providing temporary relief for private-sector plans until the first day of the plan year beginning after June 30, 2008. The temporary relief does not apply to governmental plans because of their extended effective date.

Notice 2007-69 also addresses a normal retirement age based on years of service, an issue of significant interest to many governmental plans. The final regulations do not address a normal retirement age based on years of service; however, Notice 2007-69 requested comments from governmental plans on this issue by November 2007. The IRS has not yet issued any further

guidance on this point. Notice 2007-69 does clarify that the new regulations do not prohibit a plan from making distributions at a normal retirement age based on years of service, provided the member has terminated employment prior to the distributions.

Recent Developments

The IRS does intend to issue further guidance on the topic of normal retirement age. The 2008-2009 Priority Guidance Plan issued late last year specifically listed follow-up guidance to Notice 2007-69 as an item to be addressed. Therefore, we expect to see additional information on the normal retirement age rules.

It is important to note that this is not an issue which must be addressed by governmental plans which are seeking a determination letter in Cycle C. That is, the IRS will not be reviewing a governmental plan's definition of normal retirement age under the standard provided in the final regulations prior to issuing a Cycle C determination letter.

At the NCPERS Legislative Conference in February 2009, Bill Bortz from the Treasury Department spoke on this topic. Mr. Bortz indicated that the final regulations apply to governmental plans in two areas – in-service distributions and pre-ERISA vesting requirements. The pre-ERISA vesting requirements require that a governmental plan provide that a participant is vested upon reaching normal retirement age. For these purposes, Mr. Bortz indicated that normal retirement age could be an age or a compound concept such as the lesser of age 65 or the age which was 10 years after the member began participation in the plan. He stated that a normal retirement age for vesting purposes which was only a years of service standard would not satisfy the Final Regulations but the plan could request a ruling from the IRS on whether that was permissible.

Implications for Governmental Plans

The final regulations certainly address normal retirement age with respect to in-service distributions. Thus, a governmental plan which permits a participant to begin taking distributions at an age below 55 while still employed will face problems when the rules become effective for the plan year beginning on or after January 1, 2011. Any plans in this situation should begin considering how to address that situation now, while there is plenty of time to analyze the situation and amend plan provisions before the effective date, if necessary. Plans should also consider whether they allow participants to terminate service and then return to work in a way which may be treated as an in-service distribution. (The IRS treats a participant who terminates employment subject to an agreement to return to work as not having actually separated from service. Therefore, any distributions to that participant would be treated as in-service distributions.)

Unfortunately, it is still somewhat unclear how the final regulations will apply outside that context. If in future IRS guidance the rules are applied more broadly, such as with respect to establishing the age at which a participant may retire and begin distributions, it will create problems for many governmental plans. If governmental plans must change their retirement age to comply with the regulations, many will face difficulties due to state and local laws providing for protection of benefits. Furthermore, it is not clear how the rules could impact governmental

plans which base their definition of normal retirement age for any purpose on years of service or a combination of age and years of service.

In addition, if the rules are applied more broadly, they may impact the ability of governmental plan retirees to claim the \$3,000 HELPS exclusion. As you know, this provision allows eligible retired public safety officers to exclude up to \$3,000 of retirement benefits if used for qualified health insurance premiums or long-term care insurance premiums. IRS Notice 2007-7 provides that "[t]he terms of the Eligible Government Plan from which the participant will be receiving the distributions apply in determining whether a public safety officer has separated from service by reason of disability or after attainment of normal retirement age." Thus, it appears that the plan's definition of normal retirement age controls for purposes of the HELPS exclusion. However, if the final regulations are applied broadly for governmental plans, normal retirement age could be impacted for all purposes, including the HELPS exclusion.

Conclusion

Given the extended timeline now applicable to governmental plans, we are very hopeful that the IRS will issue additional guidance with regard to retirement ages which reference only years of service. This additional time should provide an opportunity for the IRS to provide further guidance as to how broadly these rules will be applied – *i.e.*, whether they will be applied only for purposes of in-service distributions or also for other purposes such as pre-ERISA vesting standards.

In the meantime, governmental plans should examine the circumstances in which they permit in-service distributions to identify potential problems when the regulations become effective in 2011. Obviously, many governmental plans do not provide for distribution of retirement benefits while the member is still working for the same employer. For governmental plans that do allow a distribution to commence while the member is still working, the final regulations limit the ages at which such distributions are permissible. In addition, for governmental plans that allow retirement benefits to continue when the member returns to work after retiring, the plan must examine whether that retirement was a legitimate separation from service under IRS guidance. If there was not a legitimate separation from service under IRS guidance, the distribution is an in-service distribution and the final regulations will also limit the ages at which such distributions are permissible.

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