IRS and Treasury Give Back Significant Ground on Governmental Plans Normal Retirement Age Definition

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On April 18, 2012, the Internal Revenue Service (the "IRS") and the Department of the Treasury ("Treasury") announced that future regulations will significantly restrict the application to governmental retirement plans of final Treasury regulations published in 2007 that, among other things, contained new requirements regarding the definition of "normal retirement age." Beginning in 2013, these regulations would, but for the announcement, have required all governmental plans to contain a normal retirement age definition that would not have been permitted to be earlier than age 50 for qualified public safety employees and age 55 for all other employees. In the same announcement the IRS and Treasury signaled that qualified public safety employees would not, as the same final regulations had indicated, need to be covered by a separate plan in order to qualify for the younger (i.e., age 50) minimum normal retirement age.

Background

As many readers will know, the IRS in May, 2007, surprised the governmental retirement plans community by publishing final Treasury Regulations (the "2007 Final Normal Retirement Age Regulations") requiring all qualified pension plans, including governmental plans,[1] to contain a normal retirement age definition consisting of either (a) a simple chronological age, such as 55, or (b) a "later of" combination of a chronological age and a number of years of service, such as the later of age 55 or 20 years of service.[2] The 2007 Final Normal Retirement Age Regulations would thus have prohibited governmental plans from having normal retirement age definitions consisting of (x) a specified number of years of service only (e.g., 20 years), (y) an "earlier of" combination of a chronological age and a number of years of service (e.g., the earlier of age 50 or 20 years of service), or (z) a specified sum
Admittedly, the 2007 Final Normal Retirement Age Regulations' basic premise that the term "normal retirement age," which has long been important in U.S. pension law, should generally be viewed as referring to an "age" in the plain language meaning of that term, was not altogether implausible. Moreover, the 2007 Final Normal Retirement Age Regulations were, arguably, not altogether ungenerous in providing that governmental and nongovernmental plans could typically have, under the new rules, a normal retirement age as low as 55, and that a governmental plan for qualified public safety employees could have a normal retirement age as low as 50. Nevertheless, the 2007 Final Normal Retirement Age Regulations seemed to needlessly upset, without any clear statutory or policy basis for doing so, a long-standing understanding regarding acceptable normal retirement ages in governmental, if not all, pension plans. The 2007 Final Normal Retirement Age Regulations were particularly surprising because, at least on the point in question, they had not been preceded by proposed regulations and there had been no opportunity for public comment on the rule in question.

The only qualification requirements of the Code and regulations that would seem to require a governmental plan to identify a normal retirement age at all are (i) the pre-ERISA requirement, only partly statutory, that a governmental plan participant's benefits be fully vested no later than the participant's attainment of normal retirement age,[4] and (ii) the new requirement of Treas. reg. § 1.401(a)-1(b)(2)(i) itself that a plan must provide for a "normal retirement age" before the attainment of which in-service distributions of plan benefits cannot be made. However, the requirement that a member's benefits be fully vested no later than his or her attainment of normal retirement age would seem to favor, in terms of policy, an earlier normal retirement age (e.g., the earlier of the completion of 20 years of service or the attainment of age 50), rather than a later normal retirement age (e.g., the later of the completion of 20 years of service or the attainment of age 50). Moreover, it did not seem appropriate for Treasury and the IRS to require the inclusion in plan documents of a particular definition of normal retirement age for the purpose of determining when in-service distributions can be made under the plan in the case of those plans that do not provide for in-service distributions in the first place.

In addition to the Final 2007 Normal Retirement Age Regulations' not seeming to have either a clear policy or statutory basis, Treasury and the IRS seemed to be intruding into an area (the determination of an appropriate retirement age as a matter of plan design) that had traditionally been, and still seemed to be more appropriately, left to the judgment and authority of governmental plan sponsors. Finally, any change to a plan causing its normal retirement age to be later than it had previously been was obviously, as to those of the plan's current participants who did not already satisfy the new normal retirement age definition, a benefit cutback or curtailment that in most or all states would likely violate state law prohibitions against reducing promised benefits, and the IRS and Treasury were, of course, powerless to provide state law anti-cutback relief to governmental plan sponsors similar to the anti-outback relief that they provided to private employers with respect to the similar issue arising under the Employee Retirement Income Security Act of 1974, as amended.
We wrote a letter explaining the foregoing issues to Treasury and the IRS in 2010. A copy of our letter may be found here.

In a clear sign that the cries of protest by the governmental plans community were having some effect, the effective date of the 2007 Final Normal Retirement Age Regulations for governmental plans, which was originally the first day of the first plan year beginning on or after January 1, 2009, was extended by IRS Notice 2008-98 to the first day of the first plan year beginning on or after January 1, 2009, and then again by IRS Notice 2009-86 to the first day of the first plan year beginning on or after January 1, 2013.

Finally, Substantive Relief

Now, in IRS Notice 2012-29, the IRS and Treasury have signaled their agreement with many in the governmental plans community that the requirements of the 2007 Final Normal Retirement Age Regulations should not be imposed on governmental retirement plans that do not provide for in-service distributions. A copy of IRS Notice 2012-29 may be found here. The key points of IRS Notice 2012-29 may be summarized as follows:

- The IRS and Treasury are going to modify the 2007 Final Normal Retirement Age Regulations so that a governmental plan that does not "provide" for in-service distributions before a participant's attainment of age 62[6] does not need to contain a definition of normal retirement age; alternatively, a governmental plan that does not make in-service distributions may contain a definition of normal retirement age that does not conform to the requirement of the 2007 Final Normal Retirement Age Regulations that normal retirement age not be attainable until the participant has reached a specified chronological age. Thus, under the 2007 Final Normal Retirement Age Regulations, as they will be modified by the forthcoming guidance described in Notice 2012-29, a governmental plan that does not permit in-service distributions before age 62 should be able to have a normal retirement age that is (x) a number of years of service, (y) an "earlier of" combination of a number of years of service or a specified minimum age, or (z) a number that is the "sum of" a participant's age and years of service.

- Pending the issuance of the guidance described in the preceding bullet point, application of the 2007 Final Normal Retirement Age Regulations to governmental plans has been postponed to the first plan year beginning on or after the later of January 1, 2015 or the close of the first legislative session of the legislative body with authority to amend the plan commencing on or after the date three months after publication of the new final regulations in the Federal Register.

- Most governmental plans will still benefit from having an explicit definition of normal retirement age. For example, in order to be exempt from most of the requirements of IRC § 411 and related requirements of the Code, a governmental plan's benefits must be fully vested at normal retirement age.[7] Moreover, eligible retired public safety officers may benefit from their plan's having an explicit definition of normal retirement age, since that definition should help to clarify who among them are potentially eligible for the IRC § 402(l) exclusion.
of up to $3,000 annually from gross income for amounts withheld from distributions and paid by the plan to providers of health and long-term care insurance premiums for the retiree or his or her spouse or dependents. However, for these purposes, the plan's definition of "normal retirement age" need not conform to the requirements of the 2007 Final Normal Retirement Age Regulations.[8]

Caution Advisable For Governmental Plans That May Have De Facto In-Service Distribution Provisions

Note that by its terms Notice 2012-29 limits its relief to governmental plans that do not "provide" for in-service distributions. We think the Treasury's and IRS's choice of words here is significant. Generally, a plan whose terms state that distributions may commence only after "separation from service," "termination of employment," "retirement," or a similar event, should satisfy the condition of Notice 2012-29 that the plan not "provide" for in-service distributions. However, if such a plan had a policy permitting distributions in connection with an employee's reduction in hours or change in employment status, or in connection with a member's transfer to another job with the same employer (for example, in connection with a police officer's or firefighter's transfer to the civilian workforce of the same municipality), it would likely not qualify for Notice 2012-29's relief.[9]

On the other hand, a plan that may occasionally in the past, without a considered policy, have made distributions in these or similar circumstances, may wish to consider whether such distributions may have been inconsistent with the plan's governing documents; if the plan determined that they were inconsistent with the plan's governing documents, it could then put in place procedural safeguards to prevent the future recurrence of such distributions and could deal with the ramifications of the past potentially noncompliant distributions under the Employee Plans Compliance Resolution System ("EPCRS");[10] in this way, the plan would avoid concluding that it "provides" for in-service distributions and therefore should be able to determine that it is eligible for Notice 2012-29's relief.

Note that, of course, a plan provision or policy that effectively permits only the transfer of a participant's benefits to another plan of the same governmental employer in connection with the participant's change of position or job for that employer, without making possible the payment of such benefits to the participant, generally should not be viewed as a provision or policy permitting in-service distributions. Note also that a prohibited in-service distribution generally should not be viewed as having occurred where an employee separates from his or her governmental employer's service, begins to receive plan distributions on account of such separation, and then is later rehired by his or her prior employer, whether or not in a different department of that employer, and whether or not his or her pension distributions are suspended, as long as the rehiring is the result of a decision made after, and independent of, the prior separation from service, and was not agreed to or mutually planned at the time of the original separation from service.[11]

Removal of the Requirement that Qualified Public Safety Employees be Covered Under a Separate Plan In Order to Qualify for the Age 50
Minimum Normal Retirement Age

The 2007 Final Normal Retirement Age Regulations, while permitting a normal retirement age as low as 50 for qualified public safety employees (which, adopting the terminology of Notice 2012-29, we will refer to as the "age 50 safe harbor"), restricted use of the age 50 safe harbor to governmental plans substantially all of the participants in which were qualified public safety employees. Treasury and the IRS realized that this rule placed an unnecessary burden on plans that covered both qualified public safety employees and other employees in significant numbers, since the purpose of limiting the age 50 safe harbor to qualified public safety employees would be equally well-served by requiring that in a plan covering both qualified public safety and other employees, application of the age 50 safe harbor simply be limited to a group of participants substantially all of whom are qualified public safety employees. In light of this, Notice 2012-29 indicates that the forthcoming guidance modifying the 2007 Final Normal Retirement Age Regulations, as described in detail above, will also no longer restrict the age 50 safe harbor to plans substantially all of the participants in which are qualified public safety employees, but will instead only require that plans that cover both qualified public safety employees and other classifications of employees limit the application of the age 50 safe harbor to a group of employees substantially all of the members of which are qualified public safety employees.

Comments Solicited

Governmental plan sponsors and administrators who wish to comment on the issues covered by Notice 2012-29 and the changes under consideration to the 2007 Final Normal Retirement Age Regulations have until July 30, 2012 to do so. Generally, it appears to us that the only governmental plans that should have a strong interest in submitting comments on the matters discussed in Notice 2012-29 are those that believe they need to preserve the ability to make in-service distributions upon the attainment of the plan’s current normal retirement age, where that normal retirement age does not conform to the requirements of the 2007 Final Normal Retirement Age Regulations, and is below age 62, as well as, perhaps, plans that wish to weigh in early[12] on the issue of what "normal retirement age" means for purpose of IRC § 402. The set of plans meeting either of these descriptions seems likely to be small.

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[1] As defined in Internal Revenue Code § 414(d).


[3] Although it was also far from indisputable. See, e.g., IRC § 411(a)(8) for the complex definition adopted by Congress as, in effect, the maximum permissible normal retirement age for purposes of the vesting and accrual rules applicable to nongovernmental plans. See also Fry v. Exelon Corporation Cash Balance Pension Plan, 571 F.3d 644 (7th Cir. 2007).

[4] See IRC § 411(e) and the pre-ERISA vesting rules that IRC § 411(e) incorporates by reference.
See Q&A-12 added to Treas. reg. § 1.411(d)(4) by the 2007 Final Normal Retirement Age Regulations.

IRC § 401(a)(36), as enacted by the Pension Protection Act of 2006, P.L. 109-280, permits any qualified pension plan to provide for distributions to participants who have attained age 62, whether or not they have separated from the employer's service.

Note that for the purposes of both (i) the requirement that a participant's benefits be vested at normal retirement age and (ii) determining entitlement to the IRC § 402(l) income exclusion, it seems possible that a plan's normal retirement age could, if not stated explicitly in the plan, be inferred from the plan's terms, for example from a plan provision providing that, after attainment of a certain age or number of years of service, or some combination of the two, a member can retire and immediately commence receiving pension benefits without actuarial reduction. Cf. Treas. reg. § 1.1457-4(c)(3)(v)(A). Note also that, in our opinion, the IRS might challenge a normal retirement age definition, such as 5 years of service, or age 35, that seemed contrived for the purpose of maximizing participants' eligibility for IRC § 402(l) benefits.

Moreover, unless (a) the plan had a definition of normal retirement age meeting the requirements of the 2007 Final Normal Retirement Age Regulations and (b) restricted commencement of distributions in connection with such events to persons who had attained the plan's normal retirement age, the plan would need to consider whether it was in operational compliance with the prohibition against in-service distributions.


Such a situation should be contrasted with the contrived termination and rehiring considered in PLR 20114738.

And somewhat speculatively, it should be noted, since neither Treasury nor the IRS have yet broached the subject in any way themselves.

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