IRS issues proposed rules on normal retirement age for governmental plans

Who’s affected

The proposed rules affect defined benefit governmental plans. These rules also impact defined contribution governmental pension plans such as money purchase pension plans.

Background

In 2007, the IRS issued final regulations requiring that a pension plan be established and maintained primarily to provide for the payment of definitely determinable benefits over a period of years, usually for life, after retirement or attainment of normal retirement age (NRA). The regulations defined a pension plan’s NRA to 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 regulations also provided that an NRA of 62 or older (or age 50 or later, in the case of a plan for qualified public safety employees) is deemed to satisfy this requirement.

The 2007 final regulations generally were effective May 22, 2007, except for governmental plans, which had a later effective date of plan years beginning on or after January 1, 2009. The IRS extended this effective date in Notice 2008-98 (to plan years beginning on or after January 1, 2011) and again in Notice 2009-86 (in which the IRS said it intended to amend the 2007 regulations to change the effective date for governmental plan years beginning on or after January 1, 2013, but plans could rely on this extension). In Notice 2012-29, the IRS announced its intent to issue guidance on the application of the 2007 NRA rules to governmental plans.

On January 27, 2016, the IRS published proposed regulations relating to the determination of whether the NRA under a governmental plan satisfies the Internal Revenue Code requirements and whether the payment of definitely determinable benefits that commence at the plan’s NRA satisfies these requirements. The proposed rules provide:

- Safe harbors that satisfy the “reasonably representative” requirement;
- Special safe harbors for qualified public safety employees; and
- Guidance regarding multiple NRAs.

Next steps

The proposed rules affect sponsors and administrators of governmental pension plans and participants. The proposed rules are to be effective for employees hired during plan years beginning on or after the later of:

- January 1, 2017; or
- The close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after the date that is 3 months after the final rules are published in the Federal Register.

Although these rules are proposed, plans may rely on the proposed rules even before the effective date. The IRS states that if later regulations are more restrictive, they will apply without retroactive effect.

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Normal retirement age for governmental plans

The term “normal retirement age” means the earlier of (a) the time a plan participant attains normal retirement age (NRA) under the plan, or (b) the later of age 65 or the fifth anniversary of the time a plan participant began participation in the plan. However, the NRA definition does not apply to governmental plans, provided the plan satisfies pre-ERISA vesting requirements.

A governmental plan is defined as a retirement plan established and maintained for employees of:
- The United States or its agency or instrumentality;
- A state or political subdivision, or its agency or instrumentality; or
- An Indian tribal government or its subdivision, or its agency or instrumentality. (Participants must substantially perform services essential to governmental functions rather than commercial activities.)

Pre-ERISA vesting requirements

A normal retirement age under a governmental plan must satisfy pre-ERISA vesting rules. To satisfy the pre-ERISA vesting rules, a plan must provide for full vesting of the contributions made to or benefits payable under the plan for any employee who has:
- Attained normal retirement age under the plan; and
- Satisfied any reasonable and uniform requirements regarding length of service or participation.

The normal retirement age in a pension plan under pre-ERISA rules is generally the lowest age stated in the plan at which the employee has the right to:
- Retire without the consent of the employer; and
- Receive retirement benefits based on the amount of the employee's service to the date of retirement at the full rate described in the plan, without actuarial reduction or other reduction because of retirement before some later specified age.

Although normal retirement age under a pension plan is generally age 65, a plan may specify a lower age at which the employee has the right to retire without the employer's consent and to receive benefits based on the amount of the employee’s service at the full rate described in the plan if this lower age would be an age that employees customarily retire in the particular company or industry.

Proposed normal retirement age regulations

Pre-ERISA rules and years of service

The proposed rules confirm that a governmental plan must satisfy pre-ERISA vesting rules. Under the pre-ERISA vesting rules, a governmental plan may use a normal retirement age that reflects a period of service. Use of a period of service is permissible if the period of service used is reasonable and is uniformly applied.
Under the pre-ERISA rules, a governmental plan is not required to include an explicit definition of normal retirement age. If the normal retirement age is not defined, the terms of the plan must specify the earliest age at which a participant has the right to retire without employer consent and receive retirement benefits. Such benefits would be based on the participant’s service on the date of retirement at the full rate defined in the plan without actuarial reduction or other reduction because of retirement before some later date stated in the plan.

The proposed rules also provide that a governmental plan that does not allow in-service distributions before age 62 does not have to include a definition of normal retirement age.

**Reasonably representative requirement**

In general, the NRA for a governmental 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 proposed rules provide that a governmental plan satisfies the reasonably representative requirement if the NRA under the plan is:

- Age 62; or
- The later of age 62 or another specified date, such as the fifth anniversary of plan participation.

The proposed rules provide the following safe harbor normal retirement age definitions that also satisfy the reasonably representative requirement.

- A normal retirement age that is the later of age 60 or the age at which the participant has been credited with at least 5 years of service.
- A normal retirement age that is the later of age 55 or the age at which the participant has been credited with at least 10 years of service.
- A normal retirement age that is the sum of the participant’s age plus the number of years of service that have been credited to the participant under the plan equal to 80 or more. For example, a normal retirement age that is 55 for a participant who has been credited with 25 years of service would satisfy this safe harbor.
- A normal retirement age that is the earlier of the participant’s age at which the participant has been credited with 25 years of service and an age that satisfies any of the safe harbors described above. For example, a normal retirement age that is the earlier of the participant’s age at which the participant has been credited with 25 years of service under the plan and the later of age 60 or the age at which the participant has been credited with 5 years of service would satisfy the safe harbor.

**Safe harbor definitions for qualified public safety employees**

The proposed rules provide special safe harbors for qualified public safety employees. 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, any Federal law enforcement officer, any Federal customs and border protection officer, any Federal firefighter, any air traffic controller, any nuclear materials courier, any member of the United State Capitol Police, any member of the Supreme Court Police, and any diplomatic security special agent of the Department of State.

The proposed rules provide the following three safe harbors for qualified public safety employees that satisfy the reasonably representative requirement:

- A normal retirement age that is age 50.
- A normal retirement age that is the sum of the participant’s age plus the number of years of service equal to 70 or more.
- A normal retirement age with 20 years of service and any age. For example, a normal retirement age that covers only qualified public safety employees and the employee has been credited with 25 years of service would satisfy the safe harbor.
Multiple normal retirement ages

The rules permit the use of multiple NRAs where there is one NRA for one classification of employees (e.g., qualified public safety employees), and one or more other NRAs for one or more different classifications of employees. In addition, the use of one NRA for employees hired before a certain date and a different NRA for employees hired on or after that date is permissible for governmental plans.

Other normal retirement ages

If an NRA under a governmental plan fails to satisfy any of the safe harbors described above, whether the NRA satisfies the “reasonably representative” requirement is based on all of the relevant facts and circumstances. It is generally expected that a good faith determination of the typical retirement age for the industry in which the covered workforce is employed, that is made by the employer, will be given deference, assuming that the determination is reasonable under the facts and circumstances, and that the NRA is otherwise consistent with the pre-ERISA vesting requirements.

Next steps

Plan sponsors should review their plan documents to determine if their plan’s definition of normal retirement age complies with this most recent guidance. If a plan amendment is required and Prudential Retirement provides document services for your plan, we will work with you to ensure that your plan complies with this guidance.

If you have any questions regarding the guidance discussed in this Pension Analyst, you should contact your plan’s enrolled actuary or legal counsel.