

*Pension*  
ANALYST

# Compliance Bulletin

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## IRS Provides Guidance on In-Service Payments from Pension Plans

Generally, defined benefit and money purchase pension plans cannot pay benefits to participants before retirement. However, a provision in the [Pension Protection Act of 2006 \(PPA\)](#) allows pension plans to make in-service payments to employees who have reached age 62. These in-service payments are first available for plan years beginning after December 31, 2006.

Recently, the IRS published final rules that confirm that pension plans may make payments to participants who have reached normal retirement age and have not separated from service with the employer. These rules also provide guidance on how low a plan's normal retirement age may be and establish age 62 as a safe harbor normal retirement age. However, they stop short of permitting plans to make in-service payments to employees who have reached age 62 but have not reached the plan's normal retirement age.

In general, these rules are effective May 22, 2007. For governmental plans, they are effective for plan years beginning on or after January 1, 2009. For plans maintained pursuant to one or more collective bargaining agreements that were in effect on May 22, 2007, the rules do not apply before the earlier of the first plan year that begins after the expiration of the last of these agreements, or May 24, 2010. In addition, certain plans may be eligible for a [special delayed effective date and additional temporary relief as described below](#).

### Definition of Normal Retirement Age

Under these final rules, a plan's normal retirement age may not be earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed. However, a normal retirement age of age 62 or later is always acceptable.

If a plan sets the normal retirement age between age 55 and age 62, the employer must apply a good faith analysis to determine if that age is reasonable under the specific facts and circumstances. In general, a normal retirement age that is lower than age 55 is presumed to be unreasonable, unless the employer can demonstrate otherwise.

However, if substantially all the participants in the plan are qualified public safety employees, a normal retirement age of 50 or later will satisfy these new rules. A "qualified public safety employee" is any employee of a State or political subdivision who provides: police protection, firefighting services, or emergency medical services within the jurisdiction of that State or political subdivision.

If a plan's current normal retirement age does not conform to these new guidelines, it will have to be amended as of the effective date of these regulations. This would be considered an "interim amendment," correcting a disqualifying provision. In general, plan sponsors must adopt interim amendments by the later of the last day of the plan year in which they are effective or the employer's tax filing deadline (including extensions) for the tax year in which the amendment is adopted. Special amendment deadlines apply to governmental plans and plans sponsored by tax-exempt employers.

### **Anti-Cutback Relief**

A plan amendment that changes the normal retirement age to a later age may violate the anti-cutback rules by eliminating a participant's right to receive an in-service payment before the new normal retirement age. Under a special transition rule, the elimination of the ability to receive such in-service payments will not be considered a violation of the anti-cutback rules if the plan sponsor adopts the amendment after May 22, 2007, and by the end of the amendment period described above. However, this anti-cutback relief does not extend to other protected benefits. For example, an accrued benefit payable at an earlier normal retirement age cannot be reduced as the result of a new later normal retirement age. In addition, participants who became 100% vested at the earlier normal retirement age cannot have their vesting percentages reduced.

Recently the IRS published revised defined benefit plan language to assist plan sponsors who are drafting or redrafting plans to conform with applicable laws and regulations. The revised language includes sample plan language that satisfies the normal retirement age requirements. While the IRS has not yet published sample plan language for defined contribution plans, the defined benefit plan language may provide some guidance in this regard.

### **Additional Temporary Relief**

In response to plan sponsors' concerns regarding their ability to comply with the final regulations within the deadlines described above, the IRS has provided additional temporary relief. In [Notice 2007-69](#), the IRS has provided a special delayed effective date for certain plans that are required either to change their definitions of normal retirement age to comply with the final rules, or to prove that their normal retirement ages are reasonable.

The delayed effective date of the first day of the first plan year beginning after June 30, 2008, applies to:

- Plans that provide normal retirement ages lower than age 62, do not permit participants hired at age 18 or older to reach normal retirement age before age 40, and must be amended to comply with the final rules by the later of the last day of the first plan year beginning after June 30, 2008, or the due date (including extensions) for filing the employer's income tax return for the employer's taxable year that includes the first day of the first plan year beginning after June 30, 2008; and
- Plans that provide normal retirement ages lower than age 55, do not permit participants hired at age 18 or older to reach normal retirement age before age 40, and submit requests for IRS private letter rulings on whether their normal retirement ages satisfy the new rules by June 30, 2008.

This delayed effective date does not apply to governmental plans, but does apply to plans maintained pursuant to one or more collective bargaining agreements that were ratified and in effect on May 22, 2007, provided the first plan year beginning after the last agreement terminates begins before July 1, 2008.

In addition, if:

- A plan provides a normal retirement age lower than age 55;

- The plan sponsor makes a good faith determination that the plan's normal retirement age is not earlier than the typical retirement age for the industry in which the covered workforce is employed;
- The plan sponsor applies for a private letter ruling by June 30, 2008; and
- The IRS determines that the specified normal retirement age is *not* representative for that industry, the plan will only have to be amended prospectively, from the date the private letter ruling is issued, to raise the normal retirement age.

Finally, the IRS has clarified that plans may not provide normal retirement ages that are conditioned (directly or indirectly) on the completion of a stated number of years of service. The IRS believes that a normal retirement age that changes to an earlier date upon completion of a stated number of years of service will not satisfy the vesting or accrual rules. Therefore, this additional temporary relief does not extend to any violation of the vesting or accrual rules that may arise from a normal retirement age definition that is based on anything other than a stated age.

### Phased Retirement

In 2004, the IRS issued proposed rules dealing with phased retirement, under which a pension plan could make in-service distributions to participants who had not yet reached the plan's normal retirement age if certain conditions were satisfied. These rules permitted plans to pay a pro rata share of an employee's accrued benefit or account balance under a phased retirement program, provided the employee reduced his working hours. The rules also imposed nondiscrimination requirements. Until the IRS finalizes these rules, pension plans cannot make in-service payments to participants who have not reached normal retirement age.

### 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 IRS 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 the amendment deadline. The IRS has indicated that individually designed plans and multiple employer plans that submit determination letter applications during Filing Cycle B (ending January 31, 2008) must comply with both the final rules and the guidance provided in Notice 2007-69.

If you have any questions regarding the guidance discussed in this *Pension Analyst*, please contact your Prudential Retirement representative.

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