

From NCTR's Federal E-news update

NCTR, Other Public Sector Groups Seek Delay of Final IRS "Normal Retirement Age" Regulations

NCTR and 18 other public sector organizations have formally requested that the IRS delay the effective date for the application of its new "Normal Retirement Age" regulations to governmental plans indefinitely until the serious issues they present are adequately addressed. The rules, currently set to apply to plan years beginning on or after 1/1/2009, would require, for the first time, that governmental pension plans specifically define normal retirement age, or redefine normal retirement age, so that it is not based wholly or partly on years of service. There are other problems with the regulations affecting public plans that were extensively outlined in a joint comment letter to the IRS submitted by NCTR and NASRA in December of last year. Obtaining a delay in these regulations and, ultimately, major modifications for governmental plans, is one of NCTR's top priorities for 2008.

In May, 2007, the IRS issued final regulations dealing with in-service distributions after normal retirement age. The new regulations permit a pension plan to pay benefits upon an employee's attainment of "normal retirement age," even if the employee has not yet had a severance from employment with the employer maintaining the plan.

For the purposes of in-service distributions, the new regulations provide that "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." Several safe harbors are provided. For example, pursuant to a change made in the 2006 Pension Protection Act, a normal retirement age of at least age 62 is deemed to meet this new "typical retirement age" standard; for plans with normal retirement ages between ages 55 and 62, there will be a presumption that they are acceptable based on 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."

For a normal retirement age that is lower than age 55, there is a presumption that it does not meet the new standard "absent facts and circumstances that demonstrate otherwise." (For plans where substantially all of the participants in the plan are qualified public safety employees, a normal retirement age of age 50 or later is deemed to meet the new standard.)

These new regulations raise a number of worrisome issues for governmental plans. For example what about plans with different normal retirement dates for different classes of employees or different normal retirement dates for different participants in the same class of employees? Then, in August of last year, the IRS issued Notice 2007-69, which underscored that the new regulations also do not provide a safe harbor with respect to a retirement age that is conditioned (directly or indirectly) on the completion of a stated number of years of service.

However, as we know, defined benefit plans of state and local governments often define their normal retirement age or normal retirement date as the date or age when participants qualify for normal or unreduced retirement benefits under the plan, and this is often conditioned, in whole or in part, on the completion of a stated number of years of service. Other governmental pension plans do not specifically define normal retirement age. Therefore, as part of its August, 2007 notice, the IRS also requested comments from sponsors of governmental plans on whether normal retirement age under such a plan may be based on years of service.

Prior to these final regulations, there was no authority that prohibited such practices for governmental pension plans. Moreover, the IRS has routinely approved service-based normal retirement ages through the determination letter process. Accordingly, NCTR and NASRA filed comments with the IRS in December of 2007 requesting that the IRS refrain from creating standardized definitions for early or normal retirement age with regard to governmental plans, and instead defer to the applicable state or local laws, regulations and policies governing the plan.

As these joint comments pointed out, requiring governmental pension plans to specifically define normal retirement age, or redefine normal retirement age so that it is not based wholly or partly on years of service, is particularly problematic where attainment of normal retirement age entitles participants to rights that are protected by constitutional guarantees.

As the 2007 NCTR/NASRA joint comments pointed out, any time a State or local retirement system is required to be amended, it generally requires a State legislative initiative or enabling authority since pension plans of States and localities are established by these governments acting in their sovereign capacity and generally are adopted by and subject ultimately to popularly-elected governmental bodies. "The benefits provided by many public employee retirement systems are also subject to state constitutional or statutory provisions that bar public employers from taking back or reducing benefits once they have been established," the comments stressed.

However, the IRS has yet to respond by making modifications to the final regulations. Therefore, on April 30, 2008, NCTR, NASRA and 17 other public sector organizations -- including employer and employee representatives -- filed a formal request for an extension of the effective date for governmental plans "in order to permit the IRS to fully consider and respond to public sector concerns with the Final Regulations, provide clarification with regard to

unsuitable or unclear definitions, provide ample time for State and local governing bodies to respond, and to avoid confusing and potentially harmful actions.”

The request pointed out that unless changes to the final regulations are made for governmental plans, the IRS will essentially be placing States and localities in the position of either being out of compliance with Federal regulations or incurring enormous financial and administrative costs and violating their own constitutional, statutory or case law protections. Furthermore, the letter notes, without the clarifications requested by NCTR and NASRA with regard to inappropriate or unclear definitions, it is hard to see how governmental plans could reasonably be expected to follow the final regulations should they try. Finally, the letter concludes, it would also be impossible for most elected governmental bodies to amend State or local governing statutes in time to meet the required effective date.

Given the very serious disruptions that would result should the effective date for governmental plans remain unchanged, not to mention the significant financial impacts on the plan and plan sponsor that would accompany changing something as fundamental as the age at retirement, this issue is a top NCTR priority for 2008. Based on earlier discussions with the IRS and Treasury staff in 2007 concerning this issue, it would appear that some relief in connection with the final regulations is likely. However, absent any indication to date as to what this may look like, an extension of the effective date is therefore essential