



NATIONAL ASSOCIATION OF STATE RETIREMENT ADMINISTRATORS  
NATIONAL COUNCIL ON TEACHER RETIREMENT

December 28, 2007

**VIA ELECTRONIC MAIL ([notice.comments@irsounsel.treas.gov](mailto:notice.comments@irsounsel.treas.gov))**

Internal Revenue Service  
CC:PA:LPD:PR  
Room 5203  
Ben Franklin Station  
Washington, D.C. 20044

**Re: Notice 2007-69**

Dear Sir or Madam:

We are writing in response to the request for comments under Notice 2007-69 and, more generally, in response to changes under Treas. Reg. Section 1.401(a)-1(b) (the "Final Regulations") that affect governmental plans. In Notice 2007-69, the Tax Exempt and Governmental Entities Division requested comments from sponsors of governmental plans and other plans not subject to the requirements of Section 411 of the Code on whether normal retirement age under such a plan may be based on years of service. More specifically, TE/GE requested comments on whether and how a pension plan with a normal retirement age conditioned on the completion of the stated number of years of service satisfies the requirement in Treas. Reg. Section 1.401(a)-1(b)(1)(i) that a pension plan be maintained primarily to provide for the payment of definitely determinable benefits after retirement or attainment of normal retirement age and how such a plan satisfies the pre-ERISA vesting rules.

These comments are being submitted on behalf of the National Association of State Retirement Administrators ("NASRA") and the National Council on Teacher Retirement ("NCTR"). Representatives of NASRA, NCTR and systems that are part of their membership, such as the Public Employees Retirement System of Idaho ("PERSI"), among others, had the opportunity to meet with Martin L. Pippins, William Bortz, James P. Flannery and Janet Laufer on November 8, 2007. We greatly appreciate their insights on these issues. The meeting was most helpful to us in refining and directing

our comments. We also appreciate Mr. Bortz's courtesy in allowing us additional time to finalize our comments.

### **Description of NASRA and NCTR**

NASRA is a non-profit association whose members are the directors of the nation's state, territory, and largest statewide public employee retirement systems. NCTR's membership consists of 77 state, territory, local and university retirement systems that include teachers and other public employees. The retirement systems represented by our organizations collectively serve nearly 19 million working and retired state and local government workers and oversee roughly \$2.5 trillion in assets.

Five years ago, our organizations individually submitted comments to the Service in response to IRS Notice 2002-43 and identified a list of principles for phased retirement. Among them, the comments specifically noted there was strong consensus among our members that the IRS should not attempt to create standardized definitions for early or normal retirement age, but instead should defer to the applicable state or local laws, regulations and policies governing a particular plan:

*"IRS should clarify the definition of such terms as normal retirement age, early retirement age, minimum retirement age and final or highest average compensation (or whatever term is used in a particular jurisdiction) should be whatever appears in the applicable state or local laws, regulations, case law, and policies governing the retirement system. Such clarification serves to recognize that state and local governments have different ways of defining these terms."*

(Emphasis added.) Unlike the private sector, any time a State or teacher retirement system is required to be amended, it generally requires a State legislative initiative. This is because 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. Benefits are adopted through open political processes or through collective bargaining, and are established by public laws and subject to the oversight of states, localities and the public.

The request that the definitions in these plans defer to the applicable state or local laws, regulations and policies governing a particular plan seems in line with comments made by the Treasury Benefits Tax Counsel before the Ways and Means Committee earlier this year. In his testimony on Retirement Plan Fees and Expenses, he stated "The exception from ERISA of governmental plans...was a conscious decision by

Congress in enacting ERISA. State and local legislative bodies have been left to regulate these plans...”

### **An Overview of Normal Retirement Age in Governmental Pension Plans**

Nearly all defined benefit plans of state and local governments condition the receipt of normal (*i.e.*, unreduced) retirement benefits, in whole or in part, on the completion of a stated number of years of service. Many such plans define their normal retirement age or normal retirement date<sup>1</sup> as the time or times when participants qualify for normal retirement benefits under the plan. For these plans, the normal retirement age is based wholly or partly on years of service. Other governmental pension plans do not specifically define normal retirement age. Many sponsors of governmental pension plans with normal retirement ages conditioned on service as well as sponsors of governmental pension plans that do not employ either term have received a series of favorable determination letters with respect to their plans.

Under many governmental pension plans, a participant can reach normal retirement age by satisfying one of several age and service combinations. For example, a large municipal teachers plan defines normal retirement age as the earliest of (1) the date the participant reaches age 65 with 5 years of service, (2) the date the participant reaches age 55 with 25 years of service, and (3) the date the participant reaches age 50 with 30 years of service. It is also common for governmental pension plans to include among the alternative ways a participant may reach normal retirement age, the satisfaction of an age plus service combination, such as the “rule of 85,”<sup>2</sup> or the satisfaction of a reasonable service requirement at any age. In addition, normal retirement age may be different for different subgroups of employees covered by the same plan, depending on their date of hire.

While many governmental pension systems have separate plans for their teachers, public safety employees and other employee groups, this approach is not universal. Governmental pension plans often provide multiple benefit structures and cover multiple employee groups. Some states and local governments find such an approach more efficient than maintaining dozens of smaller plans with separate benefit structures or separate employee groups. Thus, the definition of normal retirement age in a governmental pension plan can be very complex, particularly if the plan covers

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<sup>1</sup> Some governmental plans use the term “normal retirement age” while others use the term “normal retirement date.” There does not appear to be any difference in meaning between the two terms. In these comments, we will use the term normal retirement age to cover both terms. We understand that there is a distinction between the terms as they are applied to private employer plans. *See*, for example, Rev. Rul. 81-211 1981-2 C.B. 98 (plan that provides for non-forfeitable benefits on normal retirement date, defined as a date that occurs after normal retirement age, will not satisfy the requirements of Section 411(a)). The distinction is not meaningful for a plan that is not subject to Section 411(a).

<sup>2</sup> Under the rule of 85, a participant will reach his normal retirement age when the sum of his age and service equals 85. The rule of 80 and the rule of 90 are also common.

multiple groups and sub-groups of employees and, like the municipal teachers plan described above, includes alternative combinations of age and service in the definition of normal retirement age.

As discussed above, for most governmental pension plans that define normal retirement age, normal retirement age is the time when participants qualify for unreduced benefits under the plan.<sup>3</sup> However, normal retirement age in some governmental pension plans triggers different rights, such as eligibility for deferred vested benefits, eligibility for in-service distributions or vesting. For example, some governmental pension plans permit groups of employees to begin taking in-service distributions, typically at a date that is on or after the date the participant has satisfied the conditions for normal retirement. Thus, normal retirement age, in the context of in-service distributions, typically has a service component.

Although governmental pension plans are not subject to the anti-cutback rules of Section 411(d)(6) of the Code, the provisions of most governmental plans are guaranteed in the state's constitution. Many states have constitutional provisions protecting against diminishing, impairing, encumbering or diverting public sector retirement funds for any reason or purpose whatsoever.<sup>4</sup> As a result, the sponsors of governmental pension plans often lack the ability to change key terms in the plan, such as the plan's normal retirement age. Thus, to the extent that the Service's interpretation of recent changes to the Final Regulations affects or impairs the guaranteed contractual rights of retirement fund members, the states or funds would be subject to numerous suits by retirees or future retirees for impairment of these contractual rights. Even when constitutional protections and collective bargaining agreements do not impact the ability of the sponsor to amend a plan, changes can typically be made to a governmental plan only with the approval of elected governmental bodies, such as through official action of the state legislature or the city or county council.

In sum, the Service is unnecessarily creating a plan qualification issue for a substantial number of plans covering millions of employees that would require elected

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<sup>3</sup> Defining normal retirement age as the date the participant has a right to unreduced benefits is consistent with the pre-ERISA definition of normal retirement age in Rev. Rul 71-24, 1971-1 C.B. 114 . It is also consistent with the definition under the Section 457 regulations, which are applicable to governmental plans. Reg. § 1.457-4(c)(3)(v) defines normal retirement age as an age that is on or after the earlier of age 65 or the date when the participant may retire and receive unreduced benefits under the basic defined benefit pension plan or money purchase pension plan.

<sup>4</sup> Based on a recent survey, approximately 25 states have some form of constitutional provisions protecting these public retirement funds or such protections have been otherwise legislatively or judicially created. *See*, for example, Michigan Constitution, Article 9, Sections 19 and 24; New Mexico Constitution, Article XX, Section 22; South Carolina Constitution, Article X, Section 16. Likewise, many states consider membership in a state employee retirement system as a contractual relationship subject to statutory and constitutional protections which may be judicially enforced. *See*, for example, Alaska Constitution, Article 12, Section 7; Arizona Constitution, Article 29, Section 1; Michigan Constitution, Article 9, Section 19.

governmental bodies to take action. In the case of our members, it would nearly universally require a State legislative initiative.

### **Summary of General Concerns**

Notice 2007-69 and the Final Regulations have caused significant concern among sponsors of governmental pension plans. Some concerns relate to the interplay between normal retirement age and in-service distributions, but some more fundamental concerns relate solely to the definition of normal retirement age. The chief concerns are:

1. Many governmental pension plans (including those whose sponsors have relied for decades on favorable determination letters) have never defined normal retirement age. The sponsors of such plans are concerned that the Final Regulations will require, for the first time, that governmental pension plans specifically define normal retirement age. Introducing a new term with uncertain legal consequences is likely to confuse their members and may impact constitutionally protected features of their plans.
2. Among governmental pension plans that define normal retirement age, many have definitions that do not completely coincide with the views expressed in Notice 2007-69. Nearly all include a service component and many reflect a normal retirement age that is based on service alone. Sponsors of such plans are deeply concerned about the implications of redefining their normal retirement ages. The concerns are heightened where attainment of normal retirement age entitles participants to rights that are protected by constitutional guarantees.
3. Sponsors of plans that currently permit participants to receive in-service distributions when the participants become eligible for normal (i.e., unreduced) retirement benefits have concerns that a regulation that does not permit in-service distributions when participants satisfy the service requirements for normal retirement benefits will interfere with rights that are protected by constitutional guarantees.
4. Sponsors, whose participating employers would like to retain valuable employees by offering them the opportunity to begin receiving unreduced retirement benefits while remaining employed are concerned that, without the ability to provide in-service retirement payments at the time when the employees first become eligible for normal retirement benefits, they will lose their most valued employees.

5. Under many governmental pension plans, a participant can reach normal retirement age by satisfying one of several age and service combinations. Sponsors of such plans would find it very difficult to select a single age to be the plan's normal retirement age. Selecting an age that is higher than the lowest age would likely impair the constitutionally protected rights of the participants. Selecting an age that is lower than the highest age could impact the actuarial cost of the plan.
6. Governmental pension plans often provide multiple benefit structures and cover multiple employee groups. The use of the term "plan" under the Final Regulations raises the concern that the Internal Revenue Service may apply the general rule and the safe harbors very narrowly in the case of governmental pension plans.
7. Sponsors of plans that cover both public safety employees and non-public safety employees, with separate benefit structures for each group, are concerned that the age-50 safe harbor in Treas. Reg. Section 1.401(a)-1(b)(2) (v) will not be available to their public safety employees because substantially all of the plan participants are not qualified public safety employees.
8. Sponsors of plans covering public safety employees are concerned that a restrictive interpretation of "normal retirement age" as used in Section 402(l) will prevent most public safety retirees from benefitting from the \$3,000 tax exclusion for distributions for health insurance and long-term care premiums.

### **Analysis of Issues Raised by the Final Regulations and Notice 2007-69**

#### **Governmental Plans Are Not Required to Define "Normal Retirement Age"**

Qualified plans that are subject to Section 411(a) of the Code are required to provide that an employee's right to his normal retirement benefit (as defined in Section 411(a)(9)) is non-forfeitable on attainment of normal retirement age (as defined in Section 411(a)(8)). Thus, plans sponsored by private employers are required to state a normal retirement age that is no later than the time the participant reaches age 65 or the 5<sup>th</sup> anniversary of his participation in the plan, if later. In addition, normal retirement age in private employer plans has a very specific meaning -- it is the date when normal retirement benefits are required to be vested.

By contrast, Section 411(a), with its requirement to state a normal retirement age, is not applicable to a governmental plan. Section 411(e) of the Code provides that governmental plans satisfy the requirements of Section 411 if they meet the vesting requirements resulting from the application of Section 401(a)(4) and Section 401(a)(7) as

in effect on September 1, 1974. We will refer to these requirements as the “pre-ERISA vesting rules.”

Section 401(a)(7), as in effect on September 1, 1974, required 100% vesting on plan termination or upon the complete discontinuance of employer contributions. Clearly, pre-ERISA Section 401(a)(7) did not require a plan to specify a normal retirement age.

Pre-ERISA Section 401(a)(4) required that contributions or benefits provided under a qualified plan may not discriminate in favor of “employees who are officers, shareholders, [supervisors], or highly-compensated employees.” The requirements of Section 401(a)(4) were made inapplicable to state and local governmental plans by the Taxpayer Relief Act of 1997.<sup>5</sup> See Section 401(a)(5)(G). Section 401(a)(5)(G) does not provide an exception for the application of pre-ERISA Section 401(a)(4) to governmental plans.

Because Section 411(a) does not apply to governmental plans, and because there is no other requirement under the qualification rules for governmental plans to define normal retirement age, it is clear that governmental plans are not required to define normal retirement age. This conclusion is supported by the Internal Revenue Service’s regulatory practice. Many governmental plans that do not define normal retirement age have consistently received favorable determination letters for decades.<sup>6</sup>

### **Normal Retirement Age in a Governmental Plan May Have a Service Component**

The Internal Revenue Service and Treasury requested comments on whether and how a governmental pension plan with a normal retirement age conditioned on the completion of service satisfies the “pre-ERISA vesting rules” and the “definitely determinable benefits rule”. We do not believe that either requirement prevents a governmental pension plan from having a normal retirement age that either includes a service component or is based entirely on the completion of service.

#### Pre-ERISA Vesting Rules

The pre-ERISA vesting rules do not preclude a governmental pension plan from having a normal retirement age that is conditioned on the completion of the stated number of years of service. We understand, based on discussions during our

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<sup>5</sup> Section 1505(d)(2) of the Taxpayer Relief Act of 1997 further provided that a state or local governmental plan will be treated as satisfying the requirements of Section 401(a)(4) for all taxable years beginning before the date of enactment.

<sup>6</sup> The regulations under Section 411 confirm that, prior to ERISA, a qualified plan is not required to state a normal retirement age. See Reg. §1.411(a)-7(b)(2). Example (2).

November 8, 2007 meeting, that some representatives of the Treasury and the Internal Revenue Service believe that the vesting requirements resulting from the application of Section 401(a)(4) include the rule described in Part 5(c) of Revenue Ruling 69-421 and that Part 5(c) prohibits governmental pension plans from having a normal retirement age that can be triggered by the completion of a service requirement. As explained above, we believe that Section 411(e)(2) of the Code does not require governmental pension plans to comply with Part 5(c) of Revenue Ruling 69-421. Even if Part 5(c) of Revenue Ruling 69-421 applies to governmental plans despite Section 401(a)(5)(G), Part 5(c) does not preclude a plan from having a normal retirement age conditioned on the completion of service. Revenue Ruling 69-421, Part 5(c)(2) provides as follows:

*Vesting on Retirement.* -- A plan will be held not to qualify if it fails to provide that an employee who has reached the normal retirement age (in the case of a pension or annuity plan) . . . ***and has satisfied any reasonable and uniformly applicable requirements as to length of service or participation***, is vested in the contributions made or benefits payable under the plan. See Rev. Rul. 66-11, C.B. 1966-1, 71 and Rev. Rul. 68-302.

(Emphasis added.) Part 5(c) clearly permits full vesting on a date that is the later of the attainment of a stated age and the satisfaction of reasonable service requirements. There is no requirement that a normal retirement age be based solely on the participant's date of birth, without reference to service or participation requirements.<sup>7</sup>

While some governmental pension plans have normal retirement ages that are expressed as **the later of** a specified age and fulfillment of service conditions, most governmental pension plans use other combinations, including (1) a requirement that age plus service equals a certain number (*e.g.*, the rule of 90), (2) a normal retirement age expressed as **the earlier of** the attainment of a specified age and the satisfaction of specified service requirements, or (3) a normal retirement age expressed solely in terms of the completion of specified service. We believe that a normal retirement age expressed in any of these manners satisfies the requirements of Part 5(c) of Revenue Ruling 69-421.

A normal retirement age based on age plus service, such as the rule of 90, is the functional equivalent of a normal retirement age that is the later of the stated age and the satisfaction of service or participation requirements. For example, a participant

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<sup>7</sup> Even the definition of normal retirement age in Section 411(a)(8), which is not applicable to governmental plans, permits normal retirement age to be expressed as the later of age 65 and the fifth anniversary of participation.

reaches normal retirement age under the rule of 90 on reaching age 60 only if the participant has 30 years of service. Age plus service requirements for normal retirement are squarely within the contemplation of Part 5(c) of Revenue Ruling 69-421 which requires vesting on reaching a specified age and satisfying specified service conditions. The rule of 90 and similar rules are merely a series of age plus service combinations, each of which satisfies Part 5(c) of Revenue Ruling 69-421.

Part 5(c) of Revenue Ruling 69-421 should also be read as approving a normal retirement age that is **the earlier of** a stated age or the satisfaction of specified service requirements. Part 5(c) does not specifically address a normal retirement age that is the earlier of a stated age or satisfaction of service or participation requirements. The proper inference from the failure to address the “earlier of” option is that it is permissible. Part 5(c) is arguably applicable to governmental plans only because it arose from the pre-ERISA non-discrimination rules. Part 5(c) addressed the specific concern that employers would use vesting rules to discriminate in favor of officers, shareholders, supervisors or highly-compensated employees. *See* Part 5(c)(1). Normal retirement ages that are the earlier of a stated age or the satisfaction of a service requirement are axiomatically more inclusive and less likely to be discriminatory than normal retirement ages that are the later of a stated age and the satisfaction of the same service requirement. Thus, if a normal retirement age expressed as the later of attaining a specified age and satisfying a service requirement does not violate pre-ERISA Section 401(a)(4), a normal retirement age that is the earlier of stated age or satisfaction of the same service requirement will not violate pre-ERISA Section 401(a)(4).<sup>8</sup>

By the same token, Part 5(c) of Revenue Ruling 69-421 should be read to permit a normal retirement age that is expressed as the time when the participant completes a service requirement. Such a provision will always be more inclusive, and less likely to be discriminatory than a requirement to complete the same service requirement and reach a specified age.

### Definitely Determinable Benefits Rule

The definitely determinable benefits rule does not preclude a qualified plan from having a normal retirement age that is conditioned on the completion of a stated number of years of service. Treas. Reg. Section 1.401(a)-1(b)(1)(i) provides in relevant part that:

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<sup>8</sup> The recent case of *Fry v. Exelon Corporation Cash Balance Plan*, No. 06-C-3723 (N.D. Ill., Mem. Op. Order), concluded that ERISA permits a definition of normal retirement age that is based on the earlier of attaining a stated age and completing a service requirement. The *Fry* case involved an interpretation of Section 3(24) of ERISA, 29 U.S.C. § 1002(24) which is not applicable to governmental plans. Nevertheless, we believe that conclusion that normal retirement age is not synonymous with a chronological age should be followed by the Internal Revenue Service.

In order for a pension plan to be a qualified plan under section 401(a), the plan must be established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to its employees over a period of years, usually for life, after retirement or attainment of normal retirement age (subject to paragraph (b)(2) of this section). A plan does not fail to satisfy this paragraph (b)(1)(i) merely because the plan provides, in accordance with Section 401(a)(36), that a distribution may be made from the plan to an employee who has attained age 62 and who has not separated from employment at the time of such distribution.

Treas. Reg. Section 1.401(a)-1(b)(1)(i), by its terms, requires benefits to be definitely determinable “after retirement *or* attainment of normal retirement age.” (Emphasis added.) However, nothing in the regulation suggests that normal retirement age must be determined with reference to the employee’s date of birth. Revenue Ruling 71-24, 1971-1 C.B. 114 further explains the requirements of Treas. Reg. § 1.401-1(b)(1)(i) as follows:

The normal retirement age is the *time* from which definitely determinable benefits under a pension plan become fixed and payable. An employee who has reached such age *and has fulfilled the service requirement* and other universally applicable provisions of the plan must be permitted to retire and to commence receiving the benefits payable thereunder.

(Emphasis added.) Revenue Ruling 71-24 clarifies that the requirement for definitely determinable benefits at normal retirement age refers to a time when the plan’s age and service requirements for normal retirement are satisfied.<sup>9</sup>

### Meaning of “Plan” under the Final Regulations

The general rule for determining normal retirement under the Final Regulations provides that “[t]he 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.” (Emphasis added.) Treas. Reg. Section 1.401(a)-1(b)(2)(i). The regulations also provide an age 50 safe harbor for qualified public safety employees stating that

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<sup>9</sup> The “definitely determinable benefits” rule is also satisfied if the plan provides for definitely determinable benefits at retirement. There is no requirement that the plan provide for definitely determinable benefits at normal retirement age and at retirement.

A normal retirement age under a *plan* that is age 50 or later 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 if substantially all of the participants in the plan are qualified public safety employees (within the meaning of section 72(t)(10)(B)).

(Emphasis added.) Treasury Regulation § 1.401(a)-1(b)(2)(v). The age 62 safe harbor also is stated in terms of a normal retirement age under a “plan.” See Treasury Regulation § 1.401(a)-1(b)(2)(ii).

The use of the term “plan” under the Final Regulations raises the concern that the Internal Revenue Service may apply the general rule and the safe harbors very narrowly in the case of governmental pension plans. For example, the general rule might be applied to require a single normal retirement age under a governmental pension plan that has multiple benefit structures or that covers multiple employee groups.<sup>10</sup> In addition, the age 62 safe harbor might be applied to limit relief to a “single plan” (within the meaning of Section 414(l) of the Code and the regulations thereunder) that has a single normal retirement age of 62 or later. Moreover, the age 50 safe harbor for qualified public safety employees might be applied to limit relief to a “single plan” (within the meaning of Section 414(l) of the Code and the regulations thereunder) in which substantially all of the participants are qualified public safety employees.<sup>11</sup> We urge the Internal Revenue Service and Treasury to (a) recognize that governmental pension plans often provide multiple benefit structures and have different rules for different employee groups and (b) interpret the Final Regulations in a manner that is consistent with that reality. A narrow interpretation of the Final Regulations would require the enormous undertaking of going through state and local governing bodies to unnecessarily fracture governmental pension systems into several smaller “plans” in order to have multiple normal retirement ages or take advantage of the safe harbor relief provided under the Final Regulations. Such action would require immense legislative and administrative efforts and only serve to increase the costs and

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<sup>10</sup> Although not applicable to governmental plans, it is worth noting that the regulations under Section 401(a)(4) contemplate multiple normal retirement ages in a single plan. See, e.g., the definition of “testing age” under Treas. Reg. Section 1.401(a)(4)-12.

<sup>11</sup> The regulations under Section 414(l) specifically do not apply to governmental plans within the meaning of Section 414(d). See Treas. Reg. Section 1.414(l)-1(a)(1). In addition, the policy behind Section 414(l) – protecting against benefit reductions in the event of plan mergers – is not relevant to determinations of when a participant should be able to draw retirement benefits. Accordingly, the regulations under Section 414(l) should not be used as a basis for interpreting the term “plan” under the Final Regulations. For example, the regulations under Section 414(l) would treat “several distinct benefit structures” as a single plan if assets related to employees under one distinct benefit structure are available to pay benefits to employees covered by other distinct benefit structures. See Treas. Reg. Section 1.414(l)-1(b)(1). We are requesting that the opposite approach be taken in interpreting the term “plan” under the Final Regulations, and that distinct benefit structures be recognized as separate plans.

complexity of administering governmental pension plans while doing little to promote sound tax administration.

We request that clarification be provided in the form of a revised regulation or other guidance of general applicability. This request would not appear to be controversial. Certainly it was not the intent of the Internal Revenue Service and Treasury, for example, to exclude from the age 50 safe harbor hundreds of thousands of safety employees who are covered by distinct benefit structures merely because the safety employees participate in statewide plans that also cover non-safety employees under different benefit structures.

### **Normal Retirement Age in the Context of Section 402(l)**

Section 402(l) of the Code provides that up to \$3,000 in annual distributions from governmental pension plans for health or long-term care insurance for “eligible retired public safety officers” is excludible from taxable income. Section 402(l)(4) defines an eligible retired public safety officer as an individual who was separated from service by reason of disability or attainment of normal retirement age. We believe that normal retirement age for purposes of Section 402(l) is the date that a public safety officer qualifies under the plan for normal, or unreduced, retirement benefits.

This approach is consistent with normal retirement age, as used in other contexts relevant to governmental pension plans. Prior to ERISA, normal retirement age in a pension plan was defined as the lowest age specified in the plan at which the participant has the right to retire without the consent of the employer and receive unreduced benefits, based on service earned. *See* Revenue Ruling 71-147, 1971-1 C.B. 116. *See also* Part 5(e) of Revenue Ruling 69-421. Treas. Reg. Section 1.457-4(c)(3)(v), which is applicable to eligible deferred compensation plans sponsored by governmental employers, defines normal retirement age as an age that is on or after the earlier of age 65 or the date when the participant may retire and receive unreduced benefits under the basic defined benefit pension plan or money purchase pension plan. Thus, the link between normal retirement age and unreduced benefits has been established for many years.

We suggest that the Internal Revenue Service should look at the definition of normal retirement age for purposes of Section 402(l) in this context. The legislative history of Section 402(l) does not suggest that the \$3,000 tax exclusion was to be available only to participants who reached a specified age. In fact, 402(l) was enacted prior to the changes to the Final Regulations).

## **Needed Changes to the Final Regulations for Governmental Plans**

Based on the general concerns expressed on pages 5 and 6 above and the analysis of the legal issues raised by the Final Regulations at pages 6 through 12 above, we believe that the following changes should be made for purposes of the application of the Final Regulations to governmental pension plans.

1. Governmental plans are not required to define normal retirement age. Accordingly, Treas. Reg. Section 1.401(a)-1(b) should make clear that the limitations imposed on normal retirement age in subsection 1.401(a)-1(b)(2) do not require a governmental pension plan to define normal retirement age and do not limit a governmental plan's ability to define normal retirement age for purposes of eligibility for unreduced benefits, eligibility for terminated-vested benefits, or for any purpose other than in-service distributions.

2. Governmental pension plans typically have normal retirement ages that include a service component or are exclusively service-based. Accordingly, Treas. Reg. Section 1.401(a)-1(b)(2) should make clear that a governmental pension plan may permit in-service distributions at a time that is no earlier than the earliest time that is reasonably representative of the typical retirement date for the employee group. If employees typically retire after completing 20, 25 or 30 years of service, in-service distributions should be permitted at that point, regardless of the employee's age.

3. Governmental pension plans often provide multiple benefit structures and cover multiple employee groups. Accordingly, the term "plan" under the Final Regulations should be interpreted to permit treatment as a separate "plan" (a) each benefit structure under a governmental pension plan that results from differences in the formula for determining the amount of retirement benefits, the time at which retirement benefits may commence, or reductions imposed for early retirement and (b) each classification of employees identified under the terms of a governmental pension plan as having rights or benefits that differ from other employees covered under the governmental pension plan.

4. Treas. Reg. Section 1.401(a)-1(b)(2) should be revised to include additional presumptions and safe harbors for governmental pension plans. We suggest the following:

a. The time at which an employee is qualified for an unreduced retirement benefit under a governmental pension plan should be presumed to satisfy the requirement that in-service distributions be no earlier than the earliest age that is reasonably representative of the typical retirement age in the industry in which the covered workforce is employed for purposes of Treas. Reg. Section 1.401(a)-1(b)(2).

b. For non-public safety employees, a normal retirement age that is no earlier than age 55 or the date the participant has earned a minimum of 25 years of service (regardless of age) should be deemed to satisfy the requirement that in-service distributions be no earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.

c. For public safety employees, a normal retirement age that is no earlier than age 50 or the date the participant has earned a minimum of 20 years of service (regardless of age) should be deemed to satisfy the requirement that in-service distributions be no earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.

d. Governmental pension plans that currently define normal retirement age or normal retirement date, whether expressed in terms of age alone, service alone, a combination of age and service, or a series of alternate age and service combinations, may allow in-service distributions at their earliest current normal retirement age or date.

In addition, we believe that normal retirement age for purposes of Section 402(l) should be the date that a public safety officer qualifies under the plan for unreduced retirement benefits.

## **Conclusion**

State and local government retirement systems are established through public laws by governments acting in their sovereign capacity and subject ultimately to the oversight of popularly-elected governmental bodies and the public. 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 system benefits, once they have been established. We believe, therefore, it was not unreasonable for our organizations to request the IRS not attempt to create standardized definitions for early or normal retirement age with regard to governmental plans, but instead defer to the applicable state or local laws, regulations and policies governing the plan.

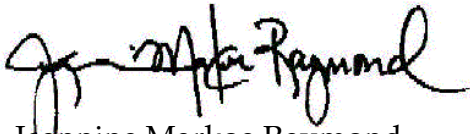
Governmental pension plan sponsors have, for many decades, conditioned eligibility for normal retirement benefits on the completion of a stated number of years of service. Many such plans have defined normal retirement age as the time the participant becomes eligible for normal retirement. Prior to the Final Regulations, there was no authority that prohibited such a practice, at least for governmental pension plans. Moreover, the Internal Revenue Service has routinely approved service-based normal retirement ages through the determination letter process. Governmental

pension plan sponsors have, in turn, relied on favorable determination letters, and the participants' rights attendant on the satisfaction of service-based normal retirement ages have become protected by constitutional guarantees.

Clearly, prohibiting service-based normal retirement ages in governmental pension plans will require plan amendments that, in many cases, will conflict with constitutional guarantees. Even changes that do not impact such guarantees will require action by state legislators and other public officials.

We appreciate the opportunity to provide comments on this very significant issue. If you have any questions, please do not hesitate to contact us.

Very truly yours,



Jeannine Markoe Raymond  
Director of Federal Relations  
NASRA  
[jeannine@nasra.org](mailto:jeannine@nasra.org)



P. Leigh Snell  
Director of Federal Governmental Relations  
NCTR  
[lsnell@nctr.org](mailto:lsnell@nctr.org)

cc: Martin L. Pippins  
cc: William Bortz  
cc: James P. Flannery  
cc: Janet Laufer  
cc: Alan Winkle  
cc: Paul Madden  
cc: David Powell  
cc: Don Wellington