

NEW IRS RULES ON NORMAL RETIREMENT AGE

Last year, the IRS, in response to several press articles on struggling public sector pension plans, decided governmental plans needed additional federal oversight and it would significantly increase audits of these defined benefit plans.

NAPO and several other public pension stakeholder organizations took issue with the IRS's plan to increase audits on public pension plans and its reasoning for doing so. NAPO is concerned that the IRS does not have the knowledge or adequate guidance necessary for properly auditing governmental plans. Additionally, the IRS has not sufficiently involved state and local government officials in the process of establishing increased enforcement in this area and may be acting outside of its jurisdiction. Lastly, the press reports on governmental plans that the IRS is citing have nothing to do with federal tax code compliance and tend to use selective examples that are usually tangled with issues relating to health care, which distort the overall picture of public pension finance.

One of the major issues at the forefront of the IRS's plan to increase audits of governmental plans is the matter of normal retirement age. The IRS, in its interpretation of the Pension Protection Act of 2006 (PPA), put out new regulations defining normal retirement age. These regulations provide that to be "a qualified plan", a pension plan must provide benefits after retirement or attainment of normal retirement age, but it will not fail to qualify if it allows distributions to be made to an employee who is still working after normal retirement age (reflecting the change made by the PPA). In interpreting this provision of the PPA in the final rules, the IRS decided to define normal retirement age and extended this definition to all defined benefit plans, including governmental plans.

The IRS's final regulations on normal retirement age, currently scheduled to take effect beginning on or after January 1, 2009, would require that governmental pension plans specifically define normal retirement age, or redefine normal retirement age, so that it is not based in any way on years of service.

The regulations state 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." For most workers, a normal retirement age that falls between ages 55 and 62 would meet the new IRS standard. The IRS has made an exception for plans where the majority of the plan participants are qualified public safety employees. For such plans, a normal retirement age of 50 or later would be qualified under the new standard.

This exception for public safety officers does not protect all officers from having their retirements adversely affected. Typical public safety pension plans are designed around years of service, usually ranging from 20 to 25 years, and not a set, arbitrary age, due to the physical and mental strain of the profession. This step by the IRS into the area of governmental plans is unprecedented. Prior to the final regulations, there was no authority that prohibited governmental pension plans from determining and setting an appropriate normal retirement age.

In fact, the IRS has routinely approved service-based normal retirement ages through the determination letter process.

The IRS will create serious problems for public pension plans, their sponsors and plan participants if it does take this step and require plans to redefine normal retirement age. There are constitutional, statutory and contractual protections afforded to benefits earned in a public defined benefit plan. The regulations would force plans to either violate these state laws or federal directives or be out of federal tax compliance. Additionally, the changes that have to be made in order to comply would incur substantial financial and administrative costs to the state.

NAPO has been working with Congress and other public sector organizations to delay or rescind these regulations since the IRS published the proposed rule. In April of this year, NAPO and 18 other stakeholder organizations filed a letter to formally request an extension of the effective date. By delaying the effective date, the IRS would give state and local governments and organizations representing public sector employees the chance to respond and provide guidance in regards to an acceptable definition of normal retirement age.

On September 18, members of Congress invited representatives from the IRS and public plan stakeholders to participate in a Roundtable discussion on issues related to IRS proposed oversight of public pension plans and the new regulations regarding normal retirement age. NAPO Executive Secretary Chris Collins attended the meeting on behalf of our association. While nothing conclusive came from the discussion, the meeting showed that the public pension plan community has the backing of Congress in protecting the retirement benefits of public employees. At the end, lawmakers called on the IRS to work in a cooperative and collaborative fashion with the public plan community to address their concerns with the proposed regulations.

NAPO anticipates that the IRS will rule on our request to delay the implementation of the new normal retirement regulations very soon. If the IRS does not rule in our favor, NAPO is ready to take immediate legislative action. We will keep you updated on any new developments on this issue.