

TD 9325
Distributions from a Pension Plan Upon Attainment of Normal Retirement Age
(Phased Retirement Regulations)

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

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Distributions From a Pension Plan Upon Attainment of Normal Retirement Age

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under sections 401(a) and 411(d)(6) of the Internal Revenue Code. These regulations provide rules permitting distributions to be made from a pension plan upon the attainment of normal retirement age prior to a participant's severance from employment with the employer maintaining the plan. These regulations provide the public with guidance regarding distributions from qualified pension plans and will affect administrators of, and participants in, such plans.

DATES: Effective Date: These regulations are effective May 22, 2007.

Applicability Dates: These regulations are generally applicable May 22, 2007. For dates of applicability, see Sec. Sec. 1.401(a)-1(b)(4) and 1.411(d)-4, A-12(a).

FOR FURTHER INFORMATION CONTACT: Cathy A. Vohs at (202) 622-6090 or Janet A. Laufer at (202) 622-6080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 401(a) sets forth the qualification requirements for a trust forming part of a stock bonus, pension, or profit-sharing plan of an employer. Several of these qualification requirements are based on a plan's normal retirement age. Section 411(a)(8) defines the term "normal retirement age" as the earlier of (a) the time a participant attains normal retirement age under the plan or (b) the later of the time a plan participant attains age 65 or the 5th anniversary of the time a plan participant commenced participation in the plan.

The definition of normal retirement age is important in applying the rules under section 411(b) which are designed to preclude avoidance of the minimum vesting standards through the backloading of benefits (for example, a benefit formula under which the rate of benefit accrual is increased disproportionately for employees with longer service) because those rules are based on the benefit payable at normal retirement age. Normal retirement age is also relevant for applying the rules relating to suspension of benefits under section 411(a)(3)(B) and the rules under section 411(b)(1)(H)(iii) that permit a plan to offset accruals after normal retirement age by either the actuarial value of distributions made after normal retirement age or the actuarial value of increases in the benefits due to delay in payment. Normal retirement age is also used in determining the minimum benefit for non-key employees in the case of a top-heavy defined benefit plan. See section 416(c)(1)(A) and (E). Also, the vesting requirements of sections 401(a)(7) and 411 are based upon normal retirement age.

Section 411(d)(6) generally prohibits a qualified plan from being amended to reduce a participant's accrued benefit and,

for this purpose, an elimination or reduction of an early retirement benefit or a retirement-type subsidy, or an elimination of an optional form of benefit, is treated as a reduction in the accrued benefit. The Secretary has the authority under section 411(d)(6) to allow amendments that eliminate an optional form of benefit.

Section 401(a) permits three types of plans to qualify under section 401(a): Stock bonus, pension, and profit-sharing plans. Section 1.401-1(a)(2)(i) and (b)(1)(i) of the Income Tax Regulations interprets what it means to be a "pension plan," and has done so since the publication of those regulations as TD 6203 (1956-2 CB 219) (see Sec. 601.601(d)(2)(ii)(b)). These regulations (the 1956 regulations) provide that a qualified plan under section 401(a) is a program and arrangement which is established and maintained by an employer "in the case of a pension plan, to provide for the livelihood of the employees or their beneficiaries after the retirement of such employees through the payment of benefits determined without regard to profits." \1 The 1956 regulations defining a qualified pension plan further provide that a pension plan must be "a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement."

\1 This rule is limited to a pension plan, which is either a defined benefit plan or a defined contribution plan that is not a stock bonus or profit-sharing plan (generally referred to as a money purchase pension plan). Other rules apply to stock bonus plans and profit-sharing plans.

Following the enactment of the Employee Retirement Income Security Act of 1974 (ERISA), 93 Public Law 406 (88 Stat. 829), the regulations under section 401(a) were modified to provide that the 1956 regulations continued to apply, except as otherwise provided. See Sec. 1.401(a)-1(b)(1)(i) and (ii). Accordingly, a pension plan is generally not permitted to pay benefits before retirement. See also Rev. Rul. 56-693 (1956-2 CB 282), as modified by Rev. Rul. 60-323 (1960-2 CB 148) (see Sec. 601.601(d)(2)(ii)(b)).

Rev. Rul. 71-24 (1971-1 CB 114) (see Sec. 601.601(d)(2)(ii)(b)) provides guidance for the treatment of benefits under a pension plan for employees who continue employment after normal retirement age. Rev. Rul. 71-24 includes an example that indicates that benefits are permitted to commence during employment after normal retirement age.

Rev. Rul. 71-147 (1971-1 CB 116) (see Sec. 601.601(d)(2)(ii)(b)) provides that the normal retirement age in a pension or annuity plan is generally the lowest age specified 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 on the date of retirement at the full rate set forth in the plan (that is, without actuarial or similar reduction because of retirement before some later specified age). While ordinarily the normal retirement age under pension and annuity plans is age 65, Rev. Rul. 71-147 permitted a different age to be specified, but an age lower than 65 was permitted only if the age represented the age at which employees customarily retire in the particular company or industry, and was not a device to accelerate funding.

Following the enactment of section 411(a)(8) (defining normal retirement age as described earlier in this preamble) under ERISA, Rev. Rul. 71-147 was modified by Rev. Rul. 78-120 (1978-1 CB 117) (see Sec. 601.601(d)(2)(ii)(b)). Under Rev. Rul. 78-120, for purposes of section 411, a pension plan is permitted to have a normal retirement age lower than age 65, regardless of the age at which employees customarily retire in the particular company or industry.

Section 401(a)(36), added by section 905(b) of the Pension Protection Act of 2006, Public Law 109-280 (120 Stat. 780) (PPA '06), provides that a trust forming part of a pension plan is not treated as failing to constitute a qualified trust under section 401(a) solely because the plan provides that a distribution may be made from such trust to an employee who has attained age 62 and who is not separated from employment at the time of such distribution. Section 401(a)(36) applies to distributions in plan years beginning after December 31, 2006.

On November 10, 2004, a notice of proposed rulemaking (REG-114726-04) under section 401 was published in the Federal Register (69 FR 65108) (the proposed regulations). The proposed regulations would have allowed in-service distributions after normal retirement age, but would not have permitted a normal retirement age to be set so low as to be a subterfuge to avoid qualification requirements. The proposed regulations would also have permitted in-service distributions before normal retirement age under a bona fide phased retirement program.

On March 14, 2005, the IRS held a public hearing on the proposed regulations. Written comments responding to the notice of proposed rulemaking were also received. In light of the enactment of section 401(a)(36) by PPA '06, only portions of the proposed regulations are being finalized at this time. The IRS recently issued a notice requesting comments as to whether the portions of the proposed regulations relating to in-service distributions pursuant to a bona fide phased retirement program should be finalized. See Notice 2007-8 (2007-3 IRB 276) (see Sec. 601.601(d)(2)(ii)(b)). The portions of the proposed regulations relating to normal retirement age and in-service distribution upon attainment of normal retirement age are being finalized by this Treasury Decision. The significant revisions to the proposed regulations are discussed in this preamble.

Explanation of Provisions and Summary of Comments

I. Overview

This Treasury Decision modifies existing regulations, including the regulations at Sec. 1.401(a)-1 which generally require a pension plan to be maintained primarily to provide systematically for the payment of definitely determinable benefits after retirement. These regulations provide two exceptions to this rule. First, they clarify that a pension plan is permitted to commence payment of retirement benefits to a participant after the participant has attained normal retirement age. The regulations also provide rules on how low a plan's normal retirement age is permitted to be and include a related exception to the anti-cutback rules of section 411(d)(6) to allow conforming amendments during a transitional period. Second, the regulations reflect the provisions of new section 401(a)(36).

II. Normal Retirement Age

A. In General

These regulations adopt the rule of the proposed regulations under which a pension plan (a defined benefit plan or money purchase pension plan) is permitted 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. Comments generally supported the inclusion of this rule as reflecting existing practice among some pension plans, based on an example in Rev. Rul. 71-24.

These regulations also include rules restricting a plan's normal retirement age. The proposed regulations would have provided that a plan's normal retirement age could not be set so low as to be a subterfuge to avoid the requirements of section 401(a), and, accordingly, normal retirement age could not be earlier than the earliest age that is reasonably representative of a typical retirement age for the covered workforce. ¹² Some comments expressed concern about the specifics of this rule, including concern about how it might be applied in various circumstances, and suggested that the regulations contain a safe harbor for which there would be no need for a demonstration of the typical retirement age for the covered workforce.

¹² The preamble to the proposed regulations noted that, while a low normal retirement age may have a significant cost effect on a traditional defined benefit plan, this effect is not as significant for defined contribution plans or for certain hybrid defined benefit plans.

These final regulations modify the proposed regulations to replace the subterfuge standard with a requirement that the normal retirement age under a plan 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. To address comments about the need for a safe harbor age, these regulations provide that a normal retirement age of at least age 62 is deemed to be not earlier than the typical retirement age for the industry in which the covered workforce is employed. Thus, a plan satisfies this safe harbor if its normal retirement age is age 62, or if its normal retirement age is the later of age 62 or another specified date, such as the later of age 62 or the fifth anniversary of plan participation. However, a plan that is subject to section 411 cannot provide for a normal retirement age that is later than the later of the time the participant attains age 65 or the fifth anniversary of the time the participant commenced participation in the plan. See section 411(a)(8)(B).

If a plan's normal retirement age is earlier than age 62, the determination of whether the age 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 is based on all of the relevant facts and circumstances. If the normal retirement age is between ages 55 and 62, then 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 (or, in the case of a multiemployer plan, made by the trustees) will be given deference, assuming that the determination is reasonable under the facts and circumstances. However, a normal retirement age that is lower than age 55 is presumed to be earlier than the earliest age that is reasonably representative of the typical retirement age for the industry of the relevant covered workforce absent facts and circumstances that demonstrate otherwise to the Commissioner.

In the case of a plan where substantially all of the participants in the plan are qualified public safety employees (within the meaning of section 72(t)(10)(B), as added by section 828 of PPA '06), a normal retirement age of age 50 or later is deemed not to 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. Under section 72(t)(10)(B), 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.

B. Section 411(d)(6) Relief

These regulations include an amendment to the existing regulations under section 411(d)(6) to permit a plan to be amended during a transition period to conform to the rules concerning normal retirement age. Thus, a plan amendment that changes the normal retirement age under the plan to a later normal retirement age (pursuant to these regulations) does not violate section 411(d)(6) merely because the amendment eliminates a right to an in-service distribution prior to the amended normal retirement age. However, this rule does not provide any other relief. For example, this rule does not permit the amendment to reduce benefits in some other manner that fails to satisfy section 411(d)(6). Neither does the rule provide relief under section 411(a)(9) (requiring that the normal retirement benefit not be less than the greater of any early retirement benefit payable under the plan or the benefit under the plan commencing at normal retirement age), section 411(a)(10) (if the amendment changes the plan's vesting rules), or section 4980F (or section 204(h), the parallel provision of ERISA) (relating to amendments that reduce the rate of future benefit accrual). See also Rev. Rul. 81-210 (1981-2 CB 89) (see Sec. 601.601(d)(2)(ii)(b)). An example is included to illustrate this rule.

Effective Dates

These regulations are generally applicable May 22, 2007. In the case of a governmental plan (as defined in section 414(d)), these regulations apply with respect to plan years beginning on or after January 1, 2009. In the case of a plan maintained pursuant to one or more collective bargaining agreements that have been ratified and are in effect on May 22, 2007, these regulations do not apply before the first plan year that begins after the last of the agreements terminates determined without regard to any extension thereof (or, if earlier, May 24, 2010).

A provision of a plan that results in the failure of the plan to satisfy Sec. 1.401(a)-1(b)(2) or (3) is a disqualifying provision described in Sec. 1.401(b)-1(b)(3)(i). Therefore, the remedial amendment period rules of Sec. 1.401(b)-1 apply. For example, in the case of a plan with a calendar plan year that is maintained by an employer with a calendar taxable year (and the plan is not a governmental plan and is not maintained pursuant to a collective bargaining agreement), the plan's remedial amendment period with respect to Sec. 1.401(a)-1(b)(2) and (3) ends on the date prescribed by law for the filing of the employer's income tax return (including extensions) for the 2007 taxable year.

In the case of a plan amendment that increases the plan's normal retirement age pursuant to this regulation, the amendment may also eliminate a right to an in-service distribution prior to the normal retirement age under the plan as amended without violating section 411(d)(6) if the amendment is adopted after May 22, 2007 and on or before the last day of the applicable remedial amendment period under Sec. 1.401(b)-1 with respect to the requirements of Sec. 1.401(a)-1(b)(2) and (3). For purposes of section 1107 of PPA '06, such an amendment is not made pursuant to PPA '06 and is not made pursuant to any regulation issued under PPA '06.

Special Analyses

It has been determined that this Treasury Decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information requirement upon small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Christopher A. Crouch (formerly of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities)), Cathy A. Vohs and Janet A. Laufer of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.401(a)-1 also issued under 26 U.S.C. 401. * * *

Par. 2. Section 1.401(a)-1 is amended by:

1. Revising paragraph (b)(1)(i).
2. Adding paragraphs (b)(2), (b)(3), and (b)(4).

The additions and revision read as follows:

Sec. 1.401(a)-1 Post-ERISA qualified plans and qualified trusts; in general.

* * * * *

(b) * * *

(1) * * *

(i) 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 is not separated from employment at the time of such distribution.

* * * * *

(2) Normal retirement age--(i) General rule. The 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.

(ii) Age 62 safe harbor. A normal retirement age under a plan that is age 62 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.

(iii) Age 55 to age 62. In the case of a normal retirement age that is not earlier than age 55 and is earlier than age 62, whether the age 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 is based on all of the relevant facts and circumstances.

(iv) Under age 55. A normal retirement age that is lower than age 55 is presumed to 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, unless the Commissioner determines that under the facts and circumstances the normal retirement age 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.

(v) Age 50 safe harbor for qualified public safety employees. 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)).

(3) Benefit distribution prior to retirement. For purposes of paragraph (b)(1)(i) of this section, retirement does not include a mere reduction in the number of hours that an employee works. Accordingly, benefits may not be distributed prior to normal retirement age solely due to a reduction in the number of hours that an employee works.

(4) Effective date. Except as otherwise provided in this paragraph (b)(4), paragraphs (b)(2) and (3) of this section are effective May 22, 2007. In the case of a governmental plan (as defined in section 414(d)), paragraphs (b)(2) and (3) of this section are effective for plan years beginning on or after January 1, 2009. In the case of a plan maintained pursuant to one or more collective bargaining agreements that have been ratified and are in effect on May 22, 2007, paragraphs (b)(2) and (3) of this section do not apply before the first plan year that begins after the last of such agreements terminate determined without regard to any extension thereof (or, if earlier, May 24, 2010. See Sec. 1.411(d)-4, A-12, for a special transition rule in the case of a plan amendment that increases a plan's normal retirement age pursuant to paragraph (b)(2) of this section.

Par. 3. Section 1.411(d)-4 is amended by adding Q&A-12 as follows:

Sec. 1.411(d)-4 Section 411(d)(6) protected benefits.

* * * * *

Q-12. Is there a transition period during which a plan is permitted to eliminate a right to in-service distributions in connection with an amendment to ensure that the plan's normal retirement age satisfies the requirements of Sec. 1.401(a)-1(b)(2)?

A-12. (a) In general. A plan amendment that changes the normal retirement age under the plan to a later normal retirement age pursuant to Sec. 1.401(a)-1(b)(2) does not violate section 411(d)(6) merely because it eliminates a right to an in-service distribution prior to the amended normal retirement age. However, this paragraph does not provide relief from any other applicable requirements; for example, this relief does not permit the amendment to violate section 411(a)(9) (requiring that the normal retirement benefit not be less than the greater of any early retirement benefit payable under the plan or the benefit under the plan commencing at normal retirement age), section 411(a)(10) (if the amendment changes the plan's vesting rules), section 411(d)(6) (other than elimination of the right to an in-service distribution prior to the amended normal retirement age), or section 4980F (relating to an amendment that reduces the rate of future benefit accrual). This paragraph only applies to a plan amendment that is adopted after May 22, 2007 and on or before the last day of the applicable remedial amendment period under Sec. 1.401(b)-1 with respect to the requirements of Sec. 1.401(a)-1(b)(2) and (3).

(b) Example. The following example illustrates the application of this section:

(i) Facts. (A) Plan A is a defined benefit plan intended to be qualified under section 401(a). Plan A is maintained by a calendar year taxpayer and has a normal retirement age that is age 45. For employees who cease employment before normal retirement age with a vested benefit, Plan A permits benefits to commence at any date after the attainment of normal retirement age through attainment of age 70½ and provides for benefits to be actuarially increased to the extent they commence after normal retirement age. For employees who continue employment after attainment of normal retirement age, Plan A provides for benefits to continue to accrue and permits benefits to commence at any time, with an actuarial increase in benefits to apply to the extent benefits do not commence after normal retirement age. Age 45 is an age that is earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.

(B) On February 18, 2008, Plan A is amended, effective May 22, 2007, to change its normal retirement age to the later of age 65 or the fifth anniversary of participation in the plan. The amendment provides full vesting for any participating employee who is employed on May 21, 2007, and who terminates employment on or after attaining age 45. The amendment provides employees who cease employment before the revised normal retirement age and who are entitled to a vested benefit with the right to be able to commence benefits at any date from age 45 to age 70½. The plan amendment also revises the plan's benefit accrual formula so that the benefit for prior service (payable commencing at the revised normal retirement age or any other age after age 45) is not less than would have applied under the plan's formula before the amendment (also payable commencing at the corresponding dates), based on the benefit accrued on May 21, 2007, and provides for service thereafter to have the same rate of future benefit accrual. Thus, for any participant employed on May 21, 2007, with respect to benefits accrued for service after May 21, 2007, the amount payable under the plan (as amended) at any benefit commencement date after age 45 is the same amount that would have been payable at that benefit commencement date under the plan prior to amendment. The plan amendment also eliminates the right to an in-service distribution between age 45 and the revised normal retirement age. Plan A has been operated since May 22, 2007, in conformity with the amendment adopted on February 18, 2008.

(ii) Conclusion. The plan amendment does not violate section 411(d)(6). Although the amendment eliminates the right to commence benefits in-service between age 45 and the revised normal retirement age, the amendment is made before the last day of the remedial amendment period applicable to the plan under Sec. 1.401(b)-1 with respect to the requirements of Sec. 1.401(a)-1(b)(2) and (3), and therefore the amendment is permitted under paragraph (a) of this A-12. Further, the amendment does not result in a reduction in any benefit for service after May 22, 2007.

Thus, the amendment does not result in a reduction in any benefit for future service, and advance notice of a significant reduction in the rate of future benefit accrual is not required under section 4980F.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved: May 9, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).