

MEMORANDUM

September 30, 2010

TO: Hank H. Kim, Executive Director and Counsel,
National Conference of Public Employee Retirement Systems

FROM: David W. Powell

RE: Attaining a Specified Number of Years of Service as Normal Retirement Age for
Qualified Plan Purposes

I. Background

Treas. Reg. Section 1.401(a)-1(b) was amended on May 21, 2007 to provide specifically that "normal retirement age under a plan must be an age". As explained in IRS Notice 2007-69, Section V:

The 2007 regulations do not provide a safe harbor or other guidance with respect to a normal retirement age that is conditioned (directly or indirectly) on the completion of a stated number of years of service. The Service and Treasury expect that a plan under which a participant's normal retirement age changes to an earlier date upon completion of a stated number of years of service typically will not satisfy the vesting or accrual rules of § 411. [emphasis added]

Because of concerns by many governmental employers that this was inconsistent with how normal retirement age was defined under their plans, Notice 2007-69 also provided, in Section VI, that

Sponsors of governmental plans and other plans not subject to the requirements of § 411 are asked to submit comments on whether normal retirement age under such a plan may be based on years of service. Comments are requested on whether and how a pension plan with a normal retirement age conditioned on the completion of a stated number of years of service satisfies the requirement in § 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.

One of the reasons that the pre-ERISA definition of normal retirement age is important is that, because, under Code section 411(e)(2), a governmental plan must meet the "vesting requirements resulting from the application of sections 401(a)(4) and 401(a)(7) as in effect on September 1, 1974." Thus, it is the definition of normal retirement age as in effect on September 1, 1974 with which governmental plans must comply.

II. Issue: Under Pre-ERISA Rules, Could Completion of a Stated Number of Years of Service Constitute Normal Retirement Age?

We understand that Treasury representatives have indicated that they believe that, under the pre-ERISA vesting rules pursuant to which an employee is vested at normal retirement age, and that still apply to governmental plans by reason of Code section 411(e)(2), normal retirement age must be a specified age; that is, it cannot be on attainment of a specified number of years of service. We believe that a review of the history of the definition of normal retirement age prior to ERISA, including at least one revenue ruling and a private letter ruling interpreting the pre-ERISA definition of normal retirement age, establish that attainment of a specified number of years of service does constitute a valid normal retirement age.

III. Analysis

A. The Pre-ERISA Definition of Normal Retirement Age.

As we understand it, the views of Treasury representatives expressed in discussions have been primarily based on a reading of Rev. Rul. 69-421. This revenue ruling is now obsolete,¹ but is an appropriate point to begin the analysis because the ruling is essentially a compendium for the purpose of "correlating those rulings that have been published relative to the qualification of plans and trusts ... with the applicable provisions of the Internal Revenue Code of 1954 and the corresponding Income Tax Regulations" prior to the enactment of ERISA.² Rev. Rul. 69-421 was not actually the last such compendium; the last such compendium was published not as a ruling but as Publication 778 in 1972.³ However, both Rev. Rul. 69-421 and Publication 778 are substantially identical regarding the definition of normal retirement age. Both provide in Part 5 as follows:

(c)...(2) **Vesting on Retirement.**--A plan will not be held 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) or the stated age or other specified event has transpired (in the case of a profit-sharing or stock bonus 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....

(e) **Normal Retirement Age.**--*The normal retirement age in a pension or annuity plan is 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 service to date of retirement at the full rate set forth in the plan (i.e., without actuarial or similar reduction because of retirement before some later specified*

¹ See Rev. Rul. 72-488.

² See Rev. Rul. 69-421, Part 1.A.

³ A copy of which can be found in Powell, Church and Governmental Plans, BNA Tax Management Portfolio #372-3rd, at Worksheet 3.

age). Ordinarily, the normal retirement age under pension and annuity plans is 65, the same as under the old-age survivors, and disability insurance provisions of the Social Security Act. A different age may be specified, provided that if it is lower than 65 it represents the age at which employees customarily retire in the particular company or industry and is not a device to accelerate funding. In profit-sharing or stock bonus plans, where there is a stated retirement age it is merely one of several events that may be designated as fixing the time for making distributions. Since the amount of the distributions is dependent upon profits, there is no definitely stated rate of benefits payable at such age. Consequently, the stated retirement age in a profit-sharing or stock bonus plan does not have the same significance as "normal retirement age" in a pension plan. [Publication 778 adds "See Rev. Rul. 71-147, C.B. 1971-1, 116."] ...

(g) Participation After Normal Retirement Age.--*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 uniformly applicable provisions of the plan must be permitted to retire and to commence receiving the benefits payable thereunder. Arrangements, however, may be mutually made for continued employment beyond normal retirement age. In such event, provision may be made with respect to the treatment of the pension benefits such as, for example, payment as though the employee had actually retired, deferment to actual retirement without increment for the interval between normal retirement date and actual retirement, or actuarial equivalent on actual retirement of the benefit at normal retirement age. Whatever provisions are made, however, must be uniformly applied to all participants. [Publication 778 adds "See Rev. Rul. 71-24, C.B. 1971-1, 114."] [emphasis added]

The issue is whether this definition of the normal retirement age as "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 service to date of retirement at the full rate set forth in the plan (i.e., without actuarial or similar reduction because of retirement before some later specified age)" - in other words, the age at which the employee would receive an unreduced benefit - means a specified chronological age such as attainment of age 55 or 65, or means whatever age the employee is when the employee is eligible for a full, unreduced benefit, for example, on completion of a specified number of years of service. We believe that the history of the provision shows that either was a permissible normal retirement age under the law prior to ERISA.

B. The History of the Definition in Rev. Rul. 69-421

The language defining normal retirement age as "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 service to date of retirement at the full rate set forth in the plan" was not original to Rev. Rul. 69-421.⁴

As noted above, Rev. Rul. 69-421 is primarily a compendium of prior IRS rulings. Part 5(c)(2) of Rev. Rul. 69-421, for example, cites Rev. Rul. 66-11 for the definition of normal retirement age, which in turn states that:

Revenue Ruling 65-178, C.B. 1965-2, 94, at page 122, provides in Part 5(g), that an employee who has reached the normal retirement age, in the case of a pension plan, and has fulfilled the service requirement and other uniformly applicable provisions of the plan must be permitted to retire and to commence receiving the benefits payable under the plan.... In any case, provision may be made for continued employment beyond *normal retirement age, or stated age* or occurrence of a specified event, but upon separation from the service of the employer after such age has been attained or event has occurred, distributions must commence. Where, however, an employee has separated from the service before attainment of *normal retirement or stated age*, the plan may provide for deferment of distributions of his vested interest to a time no later than attainment of such age.

Rev. Rul. 65-178, in turn, was another of the predecessor compendia of rulings preceding Rev. Rul. 69-421, but this illustrates in its usage of the term "normal retirement age" that normal retirement age is something different from a "stated age". Further, Rev. Rul. 65-178 is not the first such compendium of qualified plan rulings. These go all the way back to Rev. Rul. 33, C.B. 1953-1, 267 (March 16, 1953), and all had the same language defining "normal retirement age" as found in Part 5 of Rev. Rul. 69-421. In examining how this definition of normal retirement age was applied prior to ERISA, at least one revenue ruling and one private letter ruling show that it was applied to include completion of a stated number of years of service.

C. Rev. Rul. 68-35: 30 Years of Service Was a Retirement Age

Normal retirement age under a qualified plan was relevant for a number of purposes, of which vesting at normal retirement age was one. Another pre-ERISA line of IRS rulings concerned what normal retirement age was under a qualified pension plan in order to determine when a stream of payments on account of personal injury or sickness ceased to be nontaxable as, essentially, disability payments, and instead became taxable as pension payments. The point at

⁴ It is also not strictly limited to qualified plans. A similar definition appeared in the regulations governing Code section 457(b) plans, which most governmental employers maintain, and which have a special catch-up contribution election for the last three years prior to normal retirement age. That regulation, dating from 1982, provided that:

A plan may define normal retirement age as any range of ages ending no later than age 70 1/2 and beginning no earlier than the earliest age at which the participant has the right to retire under the State's basic pension plan without consent of the State and to receive immediate retirement benefits without actuarial or similar reduction because of retirement before some later specified age in the State's basic pension plan.

Treas. Reg. § 1.457-2(f)(4); continued in relevant part in current Treas. Reg. § 1.457-4(c)(3)(v).

which that changed was normal retirement age under the qualified plan. This rule permitting the tax exclusion for certain pre-retirement disability payments under a qualified plan under Code section 105(d) was a point of controversy prior to its narrowing in 1976 and then repeal in 1983. Rulings extending back to Rev. Rul. 57-76 applied a definition of "retirement age" to the qualified plan using the same language as found Part 5(e) of Rev. Rul. 69-421. As recited in some history on the subject in General Counsel Memorandum 34149 (June 23, 1969), the language in Rev. Rul. 57-76 (the same language that later appears in Rev. Rul. 69-421) was developed for this purpose, but the IRS had some difficulty persuading courts to apply it in litigation because the IRS was focusing on the earliest date an employee could take an unreduced benefit, while the courts were focusing on the criteria of when employees generally retired in actual practice, often a later date. As the General Counsel Memorandum states, "[t]o improve the Government's litigation position on the issue, it was decided that the regulation would be amended to provide a definition of retirement age" as opposed to simply relying on rulings. This resulted in the issuance of Treas. Reg. § 1.79-2(b)(3)(l)(a) in 1967 to define "retirement age" for this purpose as the earlier of:

(1) The earliest age indicated by such plan at which an active employee has the right (or an inactive individual would have the right had he continued in employment) to retire without disability and without the consent of his employer and receive immediate retirement benefits computed at either the full rate or a rate proportionate to completed service as set forth in the normal retirement formula of the plan, i.e., without actuarial or similar reduction because of retirement before some later specified age, or

(2) The age at which it has been the practice of the employer to terminate, due to age, the services of the class of employees to which he last belonged.

The IRS proceeded to apply this language - the same as the Rev. Rul. 69-421 definition of normal retirement age - in a number of rulings. Rev. Rul. 68-35 was one such ruling. The ruling states that:

The Service has consistently followed the definition of "retirement age" as published in Revenue Ruling 57-76, C.B. 1957-1, 66, and modified by Revenue Ruling 61-6, C.B. 1961-1, 15. These Revenue Rulings held that "retirement age" will be deemed to be the lowest age specified in the appropriate written employees' pension or annuity plan at which the employee, had he not been disabled and had he continued in such employment, would have had the right to retire without the consent of the employer and receive retirement benefits based on service to date of retirement computed at the full rate set forth in the plan.

The ruling also cites as authority Treas. Reg. § 1.79-2(b)(3), quoted above, which uses the same language as Rev. Rul. 69-421 defining normal retirement age and then applies the definition to various examples, one of which is:

Example (6). -- R company has a written pension plan which provides normal retirement benefits computed at a flat rate (not varied by years of service) for all

employees after 30 years of service. Employees who become disabled after 20 years of service but before completing 30 years of service may retire with benefits in proportion to completed, service payable immediately. A, an employee of R who was employed on his 24th birthday, retires at age 45 on account of disability and receives a disability pension pursuant to this plan. For purposes of section 1.105-4(a)(3)(i) of the regulations, *A reaches retirement age at age 54.* [emphasis added]

In other words, where a plan provides that an employee may retire upon completing 30 years of service, the retirement age under a definition the same as the definition of normal retirement age in Rev. Rul. 69-421 is the age at which the employee would complete 30 years of service.

D. Isidore Goodman Ruling: 35 Years of Service can be Normal Retirement Age under the Rev. Rul. 69-421 Definition

Another example in a related area where the same definition of normal retirement age was applied is Private Letter Ruling 7109286880A (Sept. 28, 1971). This private letter ruling, signed by Isidore Goodman, the respected and then already long-serving Chief of the Pension Trust Branch of the IRS, applies the definition of "normal retirement age" under a State Retirement System, which was relevant for purposes of the now-repealed maximum exclusion allowance under Code section 403(b). The ruling states that:

Part 5(e) of Revenue Ruling 69-421, Cumulative Bulletin 1969-2, 59 at page 75, states that the normal retirement age in a pension or annuity plan is 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 service to date of retirement* at the full rate set forth in the plan (i.e., without actuarial or similar reduction because of retirement before some later specified age). [emphasis added]

The facts of the ruling recite that, under the State Retirement System in question, there were two provisions for retirement age:

for [certain] participants ... the earliest of (a), (b), or (c) below:

- (a) The date at which the participants will have completed 20 years of total credited service and attained age 55 or over while in service...;
- (b) the date at which the participant will have completed 35 years of total credited service; or
- (c) age 65 for a participant with less than 20 years of total credited service...

For all other employees, normal retirement age, under the superannuation retirement provisions, is the earliest of (a), (b), of (c) below:

- (a) the date at which the participant will have completed 25 years of total credited service and will have attained age 60 while in service;

- (b) the date at which the participant will have completed 35 years of total credited service; or
- (c) age 70....

In other words, both formulas allowed employees to retire at any age if they had 35 years of service. Under these facts, the IRS held:

Therefore, in computing the exclusion allowance ... the normal retirement age ... to be used by an employee under section 1.403(b)-1(d)(4) of the regulations to determine the amount deemed contributed to the System by the employer is the earliest of (a), (b), or (c) below:

- (a) the date at which the participant will have completed 20 years of total credited service and will have attained age 55 while in service...;
- (b) the date at which the participant will have completed 35 years of total credited service; or
- (c) age 65 for a participant with less than 20 years of total credited service....

Thus, normal retirement age applying the definition under Rev. Rul. 69-421 was held to include the age at which the employee completed a specified number of years of service, even if earlier than a numerical age such as 55 or 65.⁵

IV. Summary

We believe the examples of the application of the definition of normal retirement age under tax-qualified pension plans prior to ERISA clearly illustrate that the Service accepted at the time that plans could define normal retirement age as attainment of a specified number of years of service.

⁵ To be clear, we are not, in the case of state retirement systems, arguing for unreasonably short periods of service to constitute normal retirement age, such as the 5 years of service as has been common in some cash balance plans. We note that Rev. Rul. 69-421 also indicated that retirement age should represent the age at which employees customarily retire in the particular company or industry, and this should make it clear that very short periods of service would not normally constitute a normal retirement age under the pre-ERISA rules. We believe, though, that 25, 30 and 35 years of service criteria commonly utilized by state retirement systems then and now clearly meet that criteria, and in the case of police and fire department employees, the 20 years of service criteria often used does so as well. We note, for example, that under Federal law, the uniformed services of the United States also allow retirement with an immediate unreduced pension upon completion of 20 years of service, and believe that police and fire employees should be viewed in a similar manner. 10 U.S. Code §§ 8911, 8914.