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Ten Things to Know about In-Service Retirement under PPA

The Pension Protection Act of 2006 ("PPA") permits defined benefit pension plans to offer an in-service retirement option for actively employed participants who have reached age 62. With in-service retirement, plan participants may commence their full benefits under the plan, while remaining employed by the plan sponsor. A number of employers have amended their defined benefit plans to include this feature as a way of retaining older, highly-skilled workers who would otherwise terminate employment and begin receiving their pension benefits. This memorandum provides an overview of some of the key issues that plan sponsors need to consider regarding in-service retirement.

Because in-service retirement is an optional plan feature, a plan sponsor is free to choose any effective date, as long as the change is implemented and communicated to participants in a timely fashion.

(1) Age: At what age can a participant become eligible for in-service retirement?

- PPA permits in-service retirement as early as age 62, or at any older age. It may be possible to offer in-service distributions before age 62, but only if the Plan's normal retirement age is reduced accordingly, which would have other consequences in terms of cost and plan design.

(2) Eligibility: If a plan sponsor chooses to offer an in-service retirement feature, must this feature be made available to all participants, or may it be offered to a subset of plan participants?

- In-service retirement may be offered to a subset of participants, but the eligible population may not consist disproportionately of highly compensated employees. However, union groups are excluded from this analysis and may be included or excluded from an in-service retirement feature without concern.

(3) Employment Status: Can a participant elect in-service retirement and remain a full-time employee of the plan sponsor?

- Yes. In-service retirement is different from the “phased retirement” concept proposed by the IRS several years ago. With an in-service retirement feature, a participant may receive his or her full benefit regardless of employment status.

(4) Subsidy: Can in-service retirement payments be subsidized?

- We don’t know yet. The IRS has indicated that it may not permit in-service retirement payments to be subsidized and has requested comments on this issue. The IRS also has requested comments as to whether the right to a subsidized in-service retirement benefit would be protected under Code section 411(d)(6) as part of the participant’s accrued benefit (assuming subsidized benefits are available). Given the uncertainty surrounding this issue, our recommendation is *not* to offer subsidized in-service retirement at this time.
- If a sponsor chooses to subsidize in-service distributions (assuming subsidies are permitted), the in-service option may become very popular, which could have significant cost implications for the sponsor. Also note that the historical purpose of offering early retirement subsidies is to entice older employees to terminate. A subsidized in-service retirement option could undermine that goal.

(5) Continued Accruals: Will participants who elect in-service retirement payments continue to accrue benefits after distributions commence?

- Generally yes. Code section 411(b)(1)(H) prohibits a plan from stopping benefit accruals as a result of the attainment of any age. However, for participants who have reached their normal retirement age, it may be possible to offset the required accruals by the value of the in-service benefits paid to each participant, in which case post-retirement accruals may be minimal or non-existent.

(6) Optional Forms of Benefit: Which optional forms of benefit must be made available to participants who elect in-service retirement?

- A plan is required to offer a joint and survivor annuity (with at least a 50% survivor benefit) to married participants and a single life annuity to unmarried participants but is not required to offer lump sums or other annuity options. Moreover, the payment options

offered to participants who elect in-service retirement do not have to match the payment options offered to participants who retire after they terminate. Once a payment option is offered, it generally may not be taken away, so the decision to offer a particular option should not be taken lightly.

(7) New Election at Termination: Is a participant who elects in-service retirement permitted to elect a new form of payment following termination of employment?

- A plan is not required to offer a new payment election at termination for benefits that already commenced under the in-service election. For participants whose in-service benefits begin before age 65, a plan is required to offer a new payment election for any benefits accrued after in-service payments commence. For participants whose in-service benefits begin after age 65, a plan is permitted to offer a new payment election for subsequent accruals but is not required to do so. Any subsequent payment elections would be subject to the QJSA notice and spousal consent requirements under Code section 417.

(8) Rehires: What happens if a participant elects in-service distributions, terminates employment, and is subsequently rehired?

- The plan sponsor is permitted to suspend benefit payments for rehired retirees, but this seems counterintuitive for an in-service retirement option. If the plan generally suspends benefit payments for rehires, the plan sponsor may wish to reconsider this approach in light of the decision to offer in-service retirement benefits.

(9) Disability: What happens if a participant elects in-service distributions and subsequently becomes disabled?

- If the participant is eligible for a disability retirement benefit, and the disability retirement benefit is larger than the participant's in-service retirement benefit, the plan sponsor is required to pay the disability retirement benefit. However, it may be possible to amend a plan to limit the disability retirement benefit payable to participants who elect in-service retirement.

(10) Death: What happens if a participant elects in-service retirement and dies while actively employed?

- For the in-service retirement benefits, survivor benefits may be payable depending on the form of benefit elected by the participant. For any additional benefits accrued following in-service retirement, a pre-retirement survivor benefit may be payable depending on the terms of the plan. The same rules would apply to an in-service pension recipient who terminates employment and dies before commencing distribution of the additional accruals.

If you have any questions about any of these items, or if you are considering an in-service retirement feature for your plan, feel free to contact Jonathan Zimmerman by e-mail at jzimmerman@ipbtax.com, or any member of Ivins' employee benefits team at (202)-393-7600.

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