

Part III -- Administrative, Procedural and Miscellaneous

Request for Comments on Phased Retirement

Notice 2002-43

The Internal Revenue Service and the Treasury Department request comments on issues relating to “phased retirement” arrangements under qualified defined benefit plans.

BACKGROUND

In recent years, both employers and employees have expressed interest in encouraging older, more experienced workers to stay in the workforce. One approach that some employers have taken is to offer employees the opportunity for “phased retirement.” While there is no single approach to phased retirement, these arrangements generally provide employees who are at or near eligibility for retirement with the opportunity for a reduced schedule or workload, thereby providing a smoother transition from full-time employment to retirement. These arrangements permit the employer to retain the services of an experienced employee and provide the employee with the opportunity to continue active employment at a level that also allows greater flexibility and time away from work.

As people are living longer, healthier lives, it is important to reduce the risk of individuals outliving their retirement savings. Phased retirement can provide employees additional time to save for retirement because employees continue working (while they are healthier and thus able to do so) and can accrue additional benefits and reduce or forgo early spending of their retirement savings. However, phased retirement can also increase the risk of outliving retirement savings for employees who begin drawing upon their retirement savings before normal retirement age. Even though the annuity distribution options offered by defined benefit plans preclude outliving benefits, early distribution of a portion of the participant's benefit will reduce the benefits available after normal retirement age.

ISSUES ON WHICH COMMENTS ARE REQUESTED

The Service and Treasury are interested in comments regarding approaches for encouraging employees and employers to provide opportunities for employees to continue active employment and suggestions for areas in which additional guidance might be appropriate. The following are some of the issues raised by phased retirement arrangements with respect to which comments are requested:

- Under what circumstances, if any, would permitting distributions from a defined benefit plan before the employee attains normal retirement age be consistent with the requirement that a defined benefit plan be established and maintained primarily for purposes of providing benefits after retirement?

- Would bright-line rules in this area be beneficial?
 - Would it be relevant to consider whether an employee has attained early retirement age under a plan?
 - Would it be relevant to consider the extent to which an employee has actually reduced his or her workload?
- If there are situations in which distributions from a defined benefit plan before the employee attains normal retirement age are consistent with the requirement that a defined benefit plan be established and maintained primarily for purposes of providing benefits after retirement, how would additional benefits be calculated under a defined benefit plan that provides for such distributions while the employee continues employment? For example:
 - How would the reduction in compensation for a participant who is working under a phased retirement arrangement be addressed under the plan?
 - How would any early retirement subsidy be taken into account?
- Are there other requirements applicable to defined benefit plans for which additional guidance would be necessary? For example:
 - For purposes of nondiscrimination testing and compliance with § 401(a)(4), when is a formula under a plan that permits phased retirement uniform? When does a distribution alternative fail to be currently available to a nondiscriminatory group? What other testing issues are raised under § 401(a)(4)?
 - What, if any, guidance would be necessary or appropriate to ensure that plans comply with the requirements of §§ 401(a)(11) and 417 regarding the provision of a qualified joint and survivor annuity and consent requirements?
 - Should the portion of the benefit payable as a result of phased retirement be treated as a separable benefit for purposes of these and other rules?
 - What, if any, guidance would be necessary or appropriate regarding compliance with the anti-backloading and other accrued benefit requirements under § 411?
 - What, if any, guidance would be necessary or appropriate regarding compliance with § 415?
 - Are there any issues under § 411(d)(6) that would need to be addressed for employers to be able to adopt phased retirement arrangements on an initial basis?

- How should phased retirement arrangements be distinguished from a situation in which an employee separates from employment before normal retirement age and then is hired as a consultant or independent contractor for the former employer?

COMMENTS REQUESTED

The Service and Treasury invite comments on the issues identified in this notice and other issues relating to phased retirement. Comments should be submitted by January 1, 2003, in writing, and should reference Notice 2002-43.

Comments may be submitted to CC:ITA:RU (Notice 2002-43), room 5226, Internal Revenue Service, POB 7604 Ben Franklin Station, Washington, DC 20244. Comments may be hand delivered between the hours of 8 a.m. and 5 p.m. CC:ITA:RU (Notice 2002-43), Courier's Desk, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, D.C. Alternatively, comments may be submitted via the Internet at Notice.Comments@irscounsel.treas.gov. All comments will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this notice is Michael Rubin of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, contact the Employee Plans taxpayer assistance telephone service between the hours of 8:00 a.m. and 6:30 p.m. Eastern Time, Monday through Friday by calling 1-877-829-5500 (a toll-free number). Mr. Rubin can be reached at (202) 283-9888 (not a toll-free number).