

U.S. Chamber of Commerce



February 8, 2005

Internal Revenue Service
111 Constitution Avenue, NW
Washington, DC 20210

Re: **Proposed Regulations Section 1.401(a) – Phased Retirement**
IRS and REG-114726-04

Dear Sir/Madam:

On behalf of the U.S. Chamber of Commerce, we submit this letter in response to the request for comments on Proposed Treasury Regulations issued under Code section 401(a), which were published on November 10, 2004. The U.S. Chamber is the world's largest business federation representing more than three million businesses and organizations of every size, sector, and region, with substantial membership in all 50 states. These comments have been developed with input from the Chamber's Employee Benefits Committee which is comprised of a wide variety of companies and experts in the field of the private retirement plan system.

Among the many items on the Chamber agenda, pension and retirement issues are priority items—particularly as more and more people become dependent upon pension and retirement income. The Chamber is concerned not just about current retirement systems, but also ensuring that these systems continue to be valuable retirement tools in the future. Encouraging the implementation of phased retirement programs is vital to this goal. Laws that were put into place 30 years ago may not be adequate to address changes in the current business economy. Therefore, we are very pleased to see the Department of Treasury (“Treasury”) and the Internal Revenue Service (“IRS”) address the subject of phased retirement and offer an alternative to employers and employees who are being negatively impacted by rules that do not address changes in the current workforce.

There are a number of demographic and economic factors that are changing the way that Americans think of retirement. Increased life expectancy, changing lifestyles, workforce needs, and retirement income adequacy all contribute to a need for phased retirement programs. Since the beginning of the 20th century, life expectancy has increased by nearly 30 years. When the retirement age of 65 was designated in the early 1900s, it was longer than life expectancy at the time but, today, a typical male worker can expect to spend 18 years in retirement. In addition, Americans are healthier in their retirements than ever before. Due to these advances in health and lifestyle, there is a question of whether Americans are saving enough for their retirement. At the same time

that we have indicators of a substantial untapped workforce, there will also be a growing need for workers. Estimates show that by 2006, the demand for labor will exceed supply and that by 2030 there will be a labor shortage of up to 35 million. Consequently, we will see Americans living longer, healthier lives and therefore able to work longer. In addition, businesses will be facing substantial labor shortages. Finally, many future retirees may be underestimating their income needs for retirement. All of these factors point toward phased retirement as a solution for both employees and employers in transitioning from full employment to full retirement.

The Chamber believes that the key element to the private retirement system is the voluntary nature of the system. Therefore, we are very pleased to see that the proposed regulations maintain this element by making these programs voluntary. Allowing employers to determine whether such a program meets the needs of its workforce is necessary to ensure the continued success of the private retirement system. For employers that choose to implement retirement programs, flexibility and choice are key considerations. There are several provisions in the proposed regulations that may limit a sponsor's flexibility in implementing and designing phased retirement programs. Below, we discuss these provisions and suggest alternatives that would make the provisions more useful to employers and employees.

Employers Should be able to Establish Their Own Work Reduction Percentage.

The proposed regulations require that participants in phased retirement programs reduce their number of hours worked by at least 20 percent. There does not appear to be a reason for this percentage to be established by regulation. For reasons of administration and retention, many employers may want to establish a minimum reduction percentage; however, the employer should have the flexibility to establish the reduction percentage that is appropriate for its needs. As such, the regulations should simply state that an employee's number of work hours must be reduced.

Congress Should Consider Adjusting the Age 59½ Restriction for Phased Retirement.

At one time, early retirement programs were popular because the labor supply exceeded the demand. As this has shifted, however, employers are looking for tools to encourage workers to stay rather than leave. A number of employers would like to implement phased retirement programs that begin before a participant reaches age 59½, particularly in industries where early retirement is prevalent. Specifically, an employer may be able to create an incentive through its phased retirement program that would outweigh early retirement incentives that are otherwise in place. Exempting phased retirement programs from the age restrictions (or, at the very least, lowering the age) would greatly enhance the benefit of these programs. We understand that Treasury and IRS are unable to provide relief around the age 59½ limitation due to statutory restrictions, but we ask that Treasury and IRS convey this limitation to Congress in the hopes that they can provide needed relief.

Employers Should be able to Determine the Benefit Distribution Options for Phased Retirees.

The proposed regulations prohibit the distribution of lump sum benefits and require that all other forms of benefit options be provided to a phased retiree. For the reasons discussed here, we believe that the plan sponsor should have additional flexibility in determining the form of benefit distribution. Therefore, the plan sponsor should not be prohibited from offering certain distribution options nor required to offer all distribution options.

Not allowing lump sums makes the phased retirement provisions basically unusable for companies that allow lump sums—particularly where lump sums are the common distribution method, such as in a hybrid plan or in a traditional pension plan that offers partial lump sums. Moreover, a number of employers allow such lump sums to roll into their 401(k) plan which provides a great deal of flexibility for the employee. Consequently, we suggest that the prohibition against lump sum distributions be removed from the phased retirement requirements.

We anticipate that there will be a significant administrative burden on plan sponsors if they are required to offer the same benefit options for phased retiree as they do for full retirees. For the sake of simplifying administration, we ask that IRS and Treasury consider allowing employers to restrict benefit options for a phased retiree to a single joint and survivor annuity. Employers often have several annuity benefit options in their plans that may be the result of plan mergers or acquisitions and have been kept so as not to disturb the planning of participants at full retirement. Because the phased retirement program is a new feature, however, this reasoning should not apply. Therefore, employers should not be bound to offer to phased retirees the same number of benefit options as exist for full retirees.

Employers Should Not be Required to Recalculate a Participant's Phased Retirement Benefit More Than Annually.

As proposed, the calculation of the phased retirement benefit could be complex for a plan sponsor to administer. The proposed regulations indicate that the amount of the phased benefit must be consistently proportional to the reduction in hours worked. However, our members indicate that it is likely that employees interested in participating in a phased retirement program will “phase” into retirement through multiple reduction in hours over time. For example, an employee may reduce his hours by 20 percent for six months and then reduce his hours further by an additional 20 percent each of the next four six-month periods until he is fully retired. The current proposal seems to indicate that a sponsor would have to calculate a new benefit amount each time his hours were further reduced. To avoid these complications, we suggest that the regulations limit the number of times that sponsors must recalculate the phased retirement benefit. We

suggest limiting such recalculations to once a year as a reasonable compromise for both employers and employees.¹

The Phased Retirement Benefit Payment Should be Combined with the Normal Retirement Payment Option.

We are concerned about the requirement that the form of payment elected be retained when a phased retiree fully retires. If a full retiree elects a different form of payment for the remainder of his benefit, plan sponsors could be required to maintain two different forms of benefits for a retiree with different end dates and two different benefit amounts. Furthermore, this would prevent participants in cash balance and pension equity plans from receiving their “full” benefit in the form of a lump sum, which could deter participation in such programs. Currently, if a retiree has received any previous benefits payments (i.e., a retiree who has returned to work after beginning to receive benefit payments), the retiree’s final benefit is calculated without regard to the previous benefit payments. Once the benefit is calculated, the present value of benefits already received by the retiree is subtracted from the final benefit. The retiree is then able to choose the form of payment for the remaining final benefit. We suggest that this same calculation be permitted to determine the final benefit option for phased retirees.

Key Employees Should Not be Excluded from Phased Retirement Programs.

The proposed regulations do not allow participation by key employees. For many employers, the primary purpose of implementing such a program is to retain top employees, including key employees. Including this limitation limits the benefit to an employer of implementing a phased retirement program. If there is concern about such programs being implemented exclusively for key employees, the regulations could state that such programs must be available to non-key employees and key employees on an equal basis.

The Normal Retirement Age Definition is Overly Broad.

The proposed regulations state that normal retirement “cannot be earlier than the earliest age that is reasonably representative of a typical retirement age for the covered workforce.” There is concern that this provision goes beyond the authority of the Treasury and IRS in interpreting Code Section 411(a)(8), which defines normal retirement age as the earlier of the time a participant reaches the normal retirement age under the plan, or the later of the time a participant reaches age 65 or the fifth anniversary of plan participation. Many existing plans would not satisfy this requirement if it is finalized in its current form and would have to be amended to ensure that the normal retirement age for future service reflects the typical retirement age for their workforce.

Again, we applaud the Treasury and IRS in recognizing the need for phased retirement programs and are encouraged by the efforts to provide meaningful guidance.

¹ Moreover, we suggest that the annual calculation be done at the same time for all phased retirement participants—as opposed to a calculation done on each participant’s anniversary date.

We believe that the proposed regulations go a long way in assuring employers that there is government support for these programs. We appreciate your consideration of these comments and look forward to a continued dialogue on phased retirement and other retirement issues.

Sincerely,

A handwritten signature in black ink, appearing to read "Randel K. Johnson".

Randel K. Johnson
Vice President
Labor, Immigration & Employee Benefits
U.S. Chamber of Commerce

A handwritten signature in black ink, appearing to read "Aliya S. Wong".

Aliya S. Wong
Director
Pension Policy
U.S. Chamber of Commerce