

New Requirements for Returning to Work after Retirement

During the 2025 legislative session of the West Virginia Legislature, Senate Bill (SB) 712 passed and will be law effective July 11, 2025. This legislation requires any member who retires effective August 1, 2025 or after to have a “bona fide separation from service upon retirement” to be eligible for a monthly retirement annuity. “Bona fide separation from service upon retirement” is defined in this legislation to mean that a retirant has completely terminated any “employment relationship” with the employer or any participating employer in the retirement system in which he or she is a member for a period of at least 60 consecutive days from the effective date of retirement and without a prearranged agreement to return to employment with a participating employer in that retirement plan. An “employment relationship” includes employment in any capacity, whether on a temporary full-time, temporary part-time, substitute, per diem, leased employee (i.e. independent contractor or an employee with a leasing organization), permanent part-time or permanent full-time basis.

If a retiree fails to have a “bona fide separation from service upon retirement” or if such retirant or his or her employer fails to report post-retirement employment in a manner satisfactory to the Consolidated Public Retirement Board (CPRB), then the retiree's retirement shall be voided and the member shall repay to the retirement system the gross amount of all annuity payments received related to such voided retirement. If a member's retirement is voided, any future tax repercussions will fall solely upon the member and may have negative tax consequences.

The “bona fide separation from service upon retirement” provisions in SB 712 were enacted to ensure the retirement systems administered by the CPRB comply with federal tax qualification standards established under the Internal Revenue Code. Specifically, a governmental retirement system must ensure that retirement benefits are not distributed until there has been a “bona fide separation from service” in order to retain tax-favored status. Failure to comply with these requirements could result in significant adverse consequences to members, retirees and participating employers of CPRB retirement plans. If the Internal Revenue Service were to determine that any retirement system administered by CPRB allows prearranged rehiring or inauthentic retirements, the entire retirement system could lose its tax-qualified (or pre-tax) status. Loss of tax-qualified status would result in immediate taxation of benefits for all members and retirees, the loss of tax-deferral for all ongoing contributions and potentially significant tax penalties to participating employers, members and retirees. Thus, SB 712 helps safeguard the integrity and federal tax-exempt status of the retirement systems by clearly codifying and enforcing the necessity of a genuine break in service upon retirement, which in turn protects members, retirees, participating employers and the financial health of the retirement systems.

Please contact the Retirement Section of the CPRB at (304) 558-3570 for additional questions.

WEST VIRGINIA LEGISLATURE

2025 REGULAR SESSION

Enrolled

Senate Bill 712

Passed April 12, 2025; in effect 90 days from passage

(July 11, 2025)]

CHAPTER 18. EDUCATION.

ARTICLE 7A. STATE TEACHERS RETIREMENT SYSTEM.

§18-7A-3. Definitions.

As used in this article, unless the context clearly requires a different meaning:

"Accumulated contributions" means all deposits and all deductions from the gross salary of a contributor plus regular interest.

"Accumulated net benefit" means the aggregate amount of all benefits paid to or on behalf of a retired member.

"Actuarially equivalent" or "of equal actuarial value" means a benefit of equal value computed upon the basis of the mortality table and interest rates as set and adopted by the retirement board in accordance with the provisions of this article: *Provided*, That when used in the context of compliance with the federal maximum benefit requirements of Section 415 of the Internal Revenue Code, "actuarially equivalent" shall be computed using the mortality tables and interest rates required to comply with those requirements.

"Annuities" means the annual retirement payments for life granted beneficiaries in accordance with this article.

"Average final salary" means the average of the five highest fiscal year salaries earned as a member within the last 15 fiscal years of total service credit, including military service as provided in this article, or if total service is less than 15 years, the average annual salary for the period on which contributions were made: *Provided*, That salaries for determining benefits during any determination period may not exceed the maximum compensation allowed as adjusted for cost of living in accordance with §5-10D-7 of this code and § 401(a)(17) of the Internal Revenue Code.

"Beneficiary" means the recipient of annuity payments made under the retirement system.

"Bona fide separation from service upon retirement" means that a retirant has completely terminated any employment relationship with the employer or any participating employer in the system for a period of at least 60 consecutive days from the effective date of retirement and without a prearranged agreement to return to employment with a participating employer. For purposes of this definition, an employment relationship includes employment in any capacity, whether on a permanent, full-time, part-time, substitute, per diem, temporary or leased employee basis.

"Contributor" means a member of the retirement system who has an account in the Teachers Accumulation Fund.

"Deposit" means a voluntary payment to his or her account by a member.

"Electing charter school" means a public charter school established pursuant to §18-5G-1 *et seq.* of this code which has elected to participate in this retirement system as permitted in the definitions of "Nonteaching member" and "Teacher member" in this section.

"Employer" means the agency of and within the state which has employed or employs a member, a county board of education which has employed or employs a member, or an electing charter school which has employed or employs a member. "Participating public employer" or "participating employer" means "employer" unless the context clearly requires otherwise.

"Employer error" means an omission, misrepresentation, or deliberate act in violation of relevant provisions of the West Virginia Code, or the West Virginia Code of State Regulations, or the relevant provisions of both the West Virginia Code and of the West Virginia Code of State Regulations by the participating public employer that has resulted in an underpayment or overpayment of contributions required.

"Employment term" means employment for at least 10 months, a month being defined as 20 employment days.

"Gross salary" means the fixed annual or periodic cash wages paid by a participating public employer to a member for performing duties for the participating public employer for which the member was hired. Gross salary shall be allocated and reported in the fiscal year in which the work was done. Gross salary also includes retroactive payments made to a member to correct a clerical error, or made pursuant to a court order or final order of an administrative agency charged with enforcing federal or state law pertaining to the member's rights to employment or wages, with all retroactive salary payments to be allocated to and considered paid in the periods in which the work was or would have been done. Gross salary does not include lump sum payments for bonuses, early retirement incentives, severance pay, or any other fringe benefit of any kind including, but not limited to, transportation allowances, automobiles or automobile allowances, or lump sum payments for unused, accrued leave of any type or character.

"Internal Revenue Code" means the Internal Revenue Code of 1986, as it has been amended.

"Medical examination" means an in-person or virtual examination of a member's physical or mental health, or both, by a physician or physicians selected or approved by the board; or, at the discretion of the board, a medical record review of the member's physical or mental health, or both, by a physician selected or approved by the board.

"Member" means any person who has accumulated contributions standing to his or her credit in the State Teachers Retirement System. A member shall remain a member until the benefits to which he or she is entitled under this article are paid or forfeited, or until cessation of membership pursuant to §18-7A-13 of this code.

"Members of the administrative staff of the public schools" means deans of instruction, deans of men, deans of women, and financial and administrative secretaries.

"Members of the extension staff of the public schools" means every agricultural agent, boys and girls club agent, and every member of the agricultural extension staff whose work is not primarily stenographic, clerical, or secretarial.

"New entrant" means a teacher who is not a present teacher.

"Nonteaching member" means any person, except a teacher member, who is regularly employed for full-time service by: (A) Any county board of education or educational services cooperative; (B) the State Board of Education; (C) the Higher Education Policy Commission; (D) the West Virginia Council for Community and Technical College Education; (E) a governing board, as defined in §18B-1-2 of this code; or (F) a public charter school established pursuant to §18-5G-1 *et seq.* of this code if the charter school includes in its charter contract entered into pursuant to §18-5G-7 of this code a determination to participate in the retirement systems under this article

and §18-7B-1 *et seq.* of this code, subject to §18-7B-7a of this code: *Provided*, That any person whose employment with the Higher Education Policy Commission, the West Virginia Council for Community and Technical College Education, or a governing board commences on or after July 1, 1991, is not considered a nonteaching member.

"Plan year" means the 12-month period commencing on July 1 and ending the following June 30 of any designated year.

"Present member" means a present teacher or nonteacher who is a member of the retirement system.

"Present teacher" means any person who was a teacher within the 35 years beginning July 1, 1934, and whose membership in the retirement system is currently active.

"Prior service" means all service as a teacher completed prior to July 1, 1941, and all service of a present member who was employed as a teacher and did not contribute to a retirement account because he or she was legally ineligible for membership during the service.

"Public schools" means all publicly supported schools, including colleges and universities, in this state. Unless the context clearly requires otherwise, "public school" may not include a public charter school which is not an "electing charter school" as defined herein.

"Refund beneficiary" means the estate of a deceased contributor or a person he or she has nominated as beneficiary of his or her contributions by written designation duly executed and filed with the retirement board.

"Regular interest" means interest at four percent compounded annually, or a higher earnable rate if set forth in the formula established in legislative rules, series seven of the Consolidated Public Retirement Board, 162 CSR 7.

"Regularly employed for full-time service" means employment in a regular position or job throughout the employment term regardless of the number of hours worked or the method of pay.

"Required beginning date" means April 1 of the calendar year following the later of: (1) The calendar year in which the member attains the applicable age as set forth in this paragraph; or

(2) The calendar year in which he or she retires or otherwise separates from covered employment.

The applicable age is:

(A) Seventy-two, if the individual attains age 72 prior to January 1, 2023;

(B) Seventy-three, if the individual attains age 72 after December 31, 2022, and attains age 73 before January 1, 2033; or

(C) Seventy-five, if the individual attains age 74 after December 31, 2032; provided that the applicable age shall be determined in accordance with the provisions of §401(a)(9) of the Internal Revenue Code and the Treasury Regulations thereunder, as the same may be amended from time to time.

"Retirant" means any member who commences an annuity payable by the retirement system.

"Retirement board" means the Consolidated Public Retirement Board created pursuant to §5-10D-1 *et seq.* of this code.

"Retirement system" means the State Teachers Retirement System established by this article.

"Teacher member" means the following persons, if regularly employed for full-time service:

(A) Any person employed by a public school for instructional service in the public schools of West Virginia; (B) principals employed by a public school; (C) librarians employed by a public school; (D) superintendents of schools and assistant county superintendents of schools; (E) any county school attendance director holding a West Virginia teacher's certificate; (F) members of the research, extension, administrative, or library staffs of the public schools; (G) the State Superintendent of Schools, heads and assistant heads of the divisions under his or her supervision, or any other employee under the state superintendent performing services of an

educational nature; (H) employees of the State Board of Education who are performing services of an educational nature; (I) any person employed in a nonteaching capacity by the State Board of Education, any county board of education, the State Department of Education, or the State Teachers Retirement Board, if that person was formerly employed as a teacher in the public schools; (J) all classroom teachers, principals, and educational administrators in schools under the supervision of the Division of Corrections and Rehabilitation, the Division of Health, or the Division of Human Services; (K) an employee of the State Board of School Finance, if that person was formerly employed as a teacher in the public schools; (L) employees of an educational services cooperative who are performing services of an educational nature; (M) any person designated as a 21st Century Learner Fellow pursuant to §18A-3-11 of this code who elects to remain a member of the State Teachers Retirement System provided in this article; and (N) any person employed for instructional service or as a principal or librarian by a public charter school established pursuant to §18-5G-1 *et seq.* of this code if the charter school includes in its charter contract entered into pursuant to §18-5G-7 of this code a determination to participate in the retirement systems under this article and §18-7B-1 *et seq.* of this code.

"Total service" means all service as a teacher or nonteacher while a member of the retirement system since last becoming a member and, in addition thereto, credit for prior service, if any.

Age more than 70 years shall be considered to be 70 years.

§18-7A-13a. Resumption of service by retirants.

(a) For the purpose of this section, reemployment of a retirant as a teacher or nonteacher may in no way impair the retirant's eligibility for a prior service pension or any other benefit provided by this article, except as provided in subsection (f) of this section.

(b) Retirants who qualified for an annuity because of age or service may not receive prior service allowance from the retirement board when employed as a teacher or nonteacher and when regularly employed by a public school. The payment of the allowance shall be discontinued on the first day of the month within which the employment begins and shall be resumed on the first day of the month succeeding the month within which the employment ceases. The annuity paid the retirant on first retirement resulting from the Teachers' Retirement System Fund shall continue throughout the public-school service and thereafter according to the option selected by the retirant upon first retirement.

(c) Retirants who qualified for an annuity because of disability may receive no further retirement payments if the retirement board finds that the disability of the retirant no longer exists; payment shall be discontinued on the first day of the month within which the finding is made. If the retirant returns to service as a teacher or nonteacher, he or she shall contribute to the Teachers' Retirement System Fund as a member of the system. His or her prior service eligibility, if any, shall not be impaired because of his or her disability retirement. Upon subsequent retirement, he or she shall receive credit for all contributory experience, anything to the contrary in this article notwithstanding.

(d) Notwithstanding any provision of this code to the contrary, a person who retires under the system provided by this article may subsequently become employed on either a full-time basis, part-time basis, or contract basis by any institution of higher education without any loss of retirement annuity or retirement benefits if the person's retirement commences between the effective date of the enactment of this section in 2002 and December 31, 2002: *Provided*, That the person may not be eligible to participate in any other state retirement system provided by this code.

(e) The retirement board may require of the retirants and their employers such reports, forms and verifications as it deems necessary to effectuate the provisions of this section and to ensure that a bona fide separation from service upon retirement has occurred.

30 (f) Notwithstanding any provision of this article to the contrary, a retirant who becomes
31 employed by a participating employer after the effective date of his or her retirement must have a
32 bona fide separation from service upon retirement to be eligible for an annuity payable under the
33 system. If a retirant fails to have a bona fide separation from service upon retirement or if such
34 retirant or his or her employer fails to comply with subsection (e) of this section in a manner
35 satisfactory to the board, then the member's retirement shall be voided and the member shall
36 repay to the system the gross amount of all annuity payments received related to such voided
37 retirement; provided further that the board may take any actions necessary or appropriate in
38 accordance with the provisions of §18-7A-14c of this code to recover such annuity payments so
39 that an in-service distribution is not deemed to have been made.

40 (g) Prior to any retirant subsequently becoming employed with an employer on a
41 permanent (regularly employed for full-time service or part-time service), substitute, per diem,
42 leased employee or temporary basis, the employer shall notify the retirement board and the
43 retirant, in writing, when the retirant's potential permanent, substitute, per diem, leased employee
44 or temporary employment will negatively impact the retirant's retired status or benefits. Upon the
45 retirant's acceptance of either permanent, substitute, per diem, leased employee or temporary
46 employment, the employer shall notify the retirement board, in writing, of the retirant's subsequent
47 employment.



**West Virginia
Consolidated Public Retirement Board (CPRB)**

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**Teachers'
Retirement System (TRS)**

**Retiree Return to Work
for Non-Higher
Education Employers**

COMPLETE THIS FORM ANNUALLY FOR EACH SCHOOL YEAR THE RETIREE IS EMPLOYED

Any TRS Non-Higher Education employer employing a TRS retiree is required by law to report the employment and the conditions of the employment to CPRB immediately upon the TRS retiree's acceptance of said employment. This form must be completed for all TRS retirees who return to work with a TRS Non-Higher Education employer in any capacity following a bona fide separation from service upon retirement. ***"Bona fide separation from service upon retirement" means that a retiree has completely terminated any employment relationship with the employer or any participating employer in the TRS system for a period of at least 60 consecutive days from the effective date of retirement and without a prearranged agreement to return to employment with a TRS participating employer.*** An employment relationship includes employment in any capacity, whether on a permanent, full-time, part-time, substitute, coach, per diem, temporary or leased employee (i.e. independent contractor or an employee with a leasing organization) basis. (WV Code § 18-7A-3)

A TRS retiree who becomes employed by a TRS participating employer after the effective date of his or her retirement must have a bona fide separation from service upon retirement to be eligible for a TRS annuity. If a retiree fails to have a *bona fide separation from service upon retirement* or if such retiree or his or her TRS employer fails to report post-retirement employment in a manner satisfactory to the CPRB, then the retiree's retirement **shall be voided** and the member **shall repay** to the system the gross amount of all annuity payments received related to such voided retirement. If your retirement is voided, any future tax repercussions will fall solely upon you and may have negative tax consequences. (WV Code § 18-7A-13a) **All TRS retirees who return to employment should contact PEIA, if applicable, to determine any negative impacts on their PEIA insurance if their monthly annuity is suspended or voided.**

Section 1: Retired Employee Information

Full Name	SSN (Last 4 Digits)	Date of Birth	Telephone Number
Mailing Address	City	State	Zip Code
Occupation Title Immediately Preceding Retirement	Retirement Date		
Post-Retirement Occupation Title	First Day Worked Post-Retirement in this School Year		

Section 2: Impact of Return to Employment on TRS Retirement Benefit

Review the 6 options on Pages 1 and 2, and mark the *ONE* box which applies:

☐ Any TRS **regular or disability** retiree who is a leased employee (i.e., independent contractor or an employee with a leasing organization) following a *bona fide separation from service upon retirement* is not eligible to participate in TRS and there will be no impact on their retirement benefit.

☐ A TRS **regular** retiree may accept **substitute, temporary, per diem, or part-time employment** with a TRS participating employer(s) following a *bona fide separation from service upon retirement*, other than as a college teacher, for a relatively short period (no more than a 140 day contract) without a loss of benefits. The retiree must **not** be considered in any way a permanent or regular employee. For a retiree not engaged in substitute teaching, each day a retiree is paid constitutes one day worked regardless of the number of hours or amount of pay. For a retiree engaged in substitute teaching, the number of days worked shall be determined by totaling the number of hours worked and dividing by the standard numbers of hours that a full-time teacher works per day. If 140 days is exceeded with one or multiple employers and the retiree has not been approved as a Critical Need Substitute Teacher or Critical Need Substitute Bus Driver, the retiree's monthly retirement benefit will be reduced by the prior service allowance, which is a different amount for every retiree. The retirement benefit shall be reduced for each month in which an excess day is worked, for the remainder of the fiscal year. The employer(s) **must** notify CPRB immediately upon a retiree nearing 140 days so that CPRB may reduce the annuity accordingly. The benefit reduction is effective the month in which the retiree exceeds 140 days. The retiree and employer(s) are responsible to notify CPRB of the date in which the retiree is no longer employed to enable CPRB to restore the full retirement benefit.

TRS Retiree Return to Work for Non-Higher Education Employers

Retiree Name (please print):

Section 2 (continued): Impact of Return to Employment on TRS Retirement Benefit

☐ A TRS **regular** retiree may be **regularly employed for full-time service** (permanent employment) with a TRS participating employer following a *bona fide separation from service upon retirement*; however, his or her retirement benefit will be reduced by the prior service allowance, which is a different amount for every retiree. Regularly employed for full-time service means employment in a 200 day contract or greater. The employer **must** notify CPRB immediately upon a retiree being regularly employed for full-time service so that CPRB may reduce his or her annuity accordingly. The benefit reduction is effective the month in which the retiree is regularly employed for full-time service. The original retirement benefit will be restored in the month following termination of regular full-time employment. The retiree and employer are responsible to notify CPRB of the date in which the retiree is no longer regularly employed for full-time service to enable CPRB to restore the full retirement benefit.

☐ A TRS **disability** retiree who accepts employment as a **substitute, temporary, part-time, or full-time employee** following a *bona fide separation from service upon retirement* in a different occupation other than that from which he or she was disabled may not receive a prior service allowance during such employment with a TRS employer. The employer **must** notify CPRB immediately upon a retiree being employed so that CPRB may reduce his or her annuity accordingly. CPRB shall discontinue the prior service allowance on the first day of the month within which employment begins. CPRB shall resume payment of the prior service allowance on the first day of the month succeeding the month within which the employment ceases. The retiree and employer are responsible to notify CPRB of the date in which the retiree is no longer employed to enable CPRB to restore the full retirement benefit.

☐ A TRS **disability** retiree who accepts employment as a **substitute, temporary, or part-time employee** following a *bona fide separation from service upon retirement* in the same occupation which he or she occupied immediately prior to his or her disability shall have the payment of his or her disability benefits discontinued. The employer **must** notify CPRB immediately upon a retiree being employed as a substitute, temporary, or part-time employee so that CPRB may discontinue his or her annuity. The disability annuity shall be discontinued on the first day of the month within which return to employment occurs. Upon termination of employment, the member must reapply for retirement.

☐ A TRS **disability** retiree who is **regularly employed for full-time service** (permanently employed) following a *bona fide separation from service upon retirement* in the same occupation which he or she occupied immediately prior to his or her disability shall have the payment of his or her disability benefits discontinued. The employer **must** notify CPRB immediately upon a retiree being regularly employed for full-time service so that CPRB may discontinue his or her annuity. The disability annuity shall be discontinued on the first day of the month within which the return to employment occurs, and **he or she must begin contributing to TRS**. Upon termination of employment, the member must reapply for retirement.

Section 3: Retired Employee Acknowledgment

I hereby acknowledge I have read and understand the circumstances of my employment which will negatively impact my retirement benefit.

Retired Employee Signature

Date

Section 4: Employer Information and Acknowledgment

Name of Employer

CPRB Employer Code

I hereby acknowledge the retiree has been provided this information and our agency will notify CPRB in the event the employee exceeds the limitations described above.

Representative Printed Name

Representative Signature

Date

Return this completed form to CPRB at the address at the top of Page 1.

Thought Leadership

Publication

To Be (Retired) or Not to Be (Retired)? – That Is the Question

November 15, 2024



Allowing an employee to receive a benefit before a bona fide termination or separation from service with an employer can (1) jeopardize the qualified status of the plan and (2) result in an early distribution penalty to the member. The key question is whether a governmental plan member may receive a distribution when there has not been a bona fide separation from service – a true termination of employment.



This alert provides an overview of the qualification and taxation standards under the Code and related IRS guidance that should be considered in designing or implementing a retiree reemployment policy for a governmental plan.

Qualification and Taxation Issues

General Qualification Rule

In general, a qualified pension plan is defined as “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 Under this definition, the IRS takes the position that a member of a qualified plan may only receive a retirement benefit upon the following:

- Termination of employment;
- If the plan provides, attainment of normal retirement age;²
- If the plan provides, attainment of age 59 ½ (or a later age); or
- Termination of the plan.³

Stating this rule in its simplest form, the requirement is that (absent a plan termination) a qualified governmental pension plan can only provide for payment of a pension benefit if a member (1) terminates employment with their employer, or (2) if the plan so provides, the member reaches normal retirement age (the age at which the member would receive an unreduced benefit), or age 59½ (or some later age).

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Bona Fide Termination of Employment

If a retiree reemployment policy allows a plan member to retire and be reemployed without a bona fide “termination of employment,” that policy raises a qualification issue for the plan. A bona fide termination of employment means more than a termination of “covered employment.” Instead, a termination of employment means that the employee **is no longer working for the employer**, whether as a “regular” employee, a part-time employee, a seasonal employee, a contractual employee, an independent contractor, a leased employee, etc. The IRS has issued both binding and non-binding guidance on the qualification requirement that there must be a termination from employment prior to a distribution from a qualified plan. In a private letter ruling (“PLR”), the IRS exhaustively addressed how paying retirement benefits without a termination of employment may affect the qualified status of a plan. In PLR 201147038, the IRS reached the conclusion that:

Employees who “retire” on one day in order to qualify for a benefit under the Plan, with the explicit understanding between the employee and the employer that they are not separating from service with the employer, are not legitimately retired. Accordingly, because these employees would not actually separate from service and cease performing services for the employer when they “retire,” these “retirements” would not constitute a legitimate basis to allow participants to qualify for early retirement benefits (which are then immediately suspended). Such “retirements” will violate section 401(a) of the Code and result in disqualification of the Plan under section 401(a) of the Code.

PLR 201147038 (emphasis added). The IRS also noted that “because a qualified pension plan is generally not permitted to pay benefits before retirement, an employee who ‘retires’ with the explicit understanding between the employer and employee that upon retirement the employee will immediately return to service with the employer has not legitimately retired and may not qualify for an early retirement benefit under the Plan.” Finally, the IRS reviewed court cases with regard to the meaning of the word “retire” and summarized the holding as following – an employee would not legitimately retire if he did not actually leave employment upon retirement.

Taxation Concerns for Both the Plan and the Member

In addition to the plan qualification issues, the employee may incur a premature distribution tax if the member is not age 59½, and there has not been a separation of service.

Code Section 72(t) imposes an additional 10% premature distribution tax on distributions that are paid to members prior to the date the member attains age 59½ unless an exception applies. This tax is in addition to income tax that applies to the distributed amount. The recipient of the premature distribution, not the qualified plan, is liable for this tax. The member reports the early distribution tax on IRS Form 5329, which is then filed in conjunction with the member’s regular income tax return. However, a qualified plan must properly code premature distributions when preparing IRS Form 1099-R.

The retirement distributions that are covered by exceptions to the 10% tax that are most relevant for governmental plans include (but are not limited to) the following:

- distributions made after the member’s death;
- distributions attributable to the member’s service-connected disability;
- substantially equal periodic payments commencing *after the member separates from service* and payable over the life (or life expectancy) of the member or the joint life (or joint life expectancy) of the member and member’s designated beneficiary;
- distributions made to a member who *separates from service after attainment of age 55* (age 50 or 25 years of service under the plan for public safety);
- distributions to an alternate payee pursuant to a qualified domestic relations order;
- distributions made on account of a levy under Code § 6331 on the qualified retirement plan;
- eligible terminal illness distributions;⁴ and

- qualified disaster recovery distributions.⁵

Two of these exceptions upon which many governmental plan retirees rely to avoid the tax penalty – the substantially equal periodic payment exception and the age 55 (age 50/25 years of service) exception – require a “separation from service.”

There is no exception for normal retirement age under Code Section 72(t), so, in preparing Forms 1099-R, the governmental plan payor must focus on age and separation from service in order to determine whether a retiree will be subject to a 10% taxation penalty.

The concept of “separation from service” for taxation purposes is viewed as a more stringent test than “termination of employment” for qualification purposes. There are a series of cases that define what is a separation from service for purpose of taxation. For example, in *Ridenour v. U.S.*, 52 AFTR 2d 83-5584 (Cl. Ct. 1983), the Claims Court held that promotion from the status of common law employee to partner at the same firm was *not* a separation from service. The court drew a distinction between one who continues to provide services and one who discontinues providing services, rather than upon the particular status of the person rendering the service. The Claims Court concluded that one who continues to provide services has not separated from the service within the meaning of Code Section 402(e)(4)(A)(iii).

If a reemployment policy allows a member to “retire” and commence a retirement benefit without a bona fide separation from service, and if that member is less than 59½ when they receive a benefit, the governmental plan must code the Form 1099-R with respect to those benefit payments such that the retiree will be subject to a 10% penalty on the taxable amount of the benefit.

Summary of IRS Position

No Pre-Arranged Agreement to Reemploy. It is clear from the IRS guidance that a prearranged agreement for reemployment by the **same employer** will not be treated by the IRS as a termination from employment. Therefore, unless the plan provides for an in-service distribution at normal retirement age (or age 59½), a member may not be permitted to receive a retirement benefit if, pre-retirement, the member and the member’s employer have entered into a prearranged agreement for employment.

No Continuation of the Employment Relationship. The IRS takes the position that the employment relationship must not continue post-retirement, even if there is a substantial modification of the hours worked. The IRS may not consider the employment relationship to have been severed if the member becomes the leased employee or independent contractor of the same employer. A reemployment policy should clarify that a termination of employment requires termination of the employment relationship and that moving to a temporary or part-time position, or becoming a leased employee or an independent contractor, is not sufficient to constitute a termination.

Period of Separation from Employment. The IRS has stated repeatedly that the determination of whether there is or is not a severance from employment is to be determined using a facts and circumstances test. In this regard, the IRS has not established a “safe harbor” period for severance from employment. However, based on the regulations under Code Sections 410 and 457, which are cited in PLR 201147038, some governmental plans have implemented a required minimum period of time (typically from 6-12 months) without performing service (and without a pre-existing arrangement for re-employment) to demonstrate reasonable compliance with the facts and circumstances standard.

Alternatively, if in-service distributions were allowed at the normal retirement age (or age 59½), a member could commence their benefits without a bona fide separation of service. However, commencing an in-service distribution prior to age 59½ will result in an early distribution penalty.

For more information about how the separation from service and reemployment rules may affect your qualified retirement plan(s), please contact your Ice Miller Workplace Solutions lawyer with whom you regularly work.

[1] Treas. Reg. §1.401-1(b)(1)(i).

[2] In 2016, the IRS issued proposed regulations defining normal retirement age for qualified governmental defined benefit plans.

(⁶2016 NRA Regulations”). The 2016 NRA Regulations place parameters on what the IRS considers a permissible normal retirement age for purposes of permitting in-service distributions. 81 FR 4599.

[3] Treas. Reg. §1.401-1(a)(2)(i); Rev. Rul. 74-254, 1974-1 C.B. 94; Code § 401(a)(36).

[4] Code § 72(t)(2)(L), added by SECURE 2.0.

[5] Code §§ 72(t)(2)(M) and 72(t)(11), added by SECURE 2.0.

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