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PENSION ANALYST
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IRS no longer intends to rule on retiree lump sum payments

In 2015, the IRS announced that it intended to amend the required minimum distribution rules to provide that defined benefit plans are generally not allowed to replace any annuity payments being paid by a qualified defined benefit plan. As a result, plan sponsors had been excluding retirees from lump-sum windows. On March 6, the IRS issued Notice 2019-18 stating that it no longer intends to amend the minimum distribution rules to address retiree lump-sum windows, but will continue to study the issue and may issue future guidance.

Background and overview

Under the Internal Revenue Code (IRC) the required minimum distribution rules (RMD) require that an employee must begin receiving his pension benefits once he reaches his required beginning date (RBD). The RBD generally is the April 1 of the calendar year following the later of (1) the calendar year in which the employee attains age 70½ or (2) the calendar year in which the employee retires.

Usually, these benefits are paid in the form of an annuity. To satisfy the RMD rules, the annuity must be paid periodically. Payment intervals cannot be more than one year in length, but may be shorter. Most plans make monthly payments. Under the RMD rules, payments must be made:

- Over the life (or lives) of the participant (and his designated beneficiary); or
- Over a period certain that is not longer than the life expectancy (or joint and last survivor expectancy) of the participant (and his designated beneficiary).

A single life annuity (which pays benefits for the life of the participant) and a joint and survivor annuity with the participant's spouse designated as the beneficiary automatically satisfy these rules.

Generally, the RMD rules prohibit any change in the period or form of payment after payment has begun. However, under the RMD rules, there are certain conditions that permit changes to the payment period after payments have begun. These exceptions are:

- Payment of increased benefits that result from a plan amendment;
- Increased benefits as the result of a participant's death or retirement; or
- Plan termination.

In the years before 2015, defined benefit plan sponsors amended their plans, under the plan amendment exception, to provide a limited period ("window period") during which retirees who were receiving annuity payments were offered a one-time opportunity to convert that annuity into a lump sum that was immediately payable. These arrangements are referred to as retiree lump sum windows. The IRS has issued several private letter rulings which approve these lump sum windows.

In early 2015, the Government Accountability Office (GAO) released a report that reviewed lump sum windows offered by plan sponsors. The GAO reviewed disclosures provided to affected participants and concluded that the disclosures lacked sufficient information needed to make an informed decision regarding a lump sum election.

Additionally, the IRS concluded that permitting lump sum payments to replace ongoing annuity payments was contrary to RMD rules to provide ongoing annuity payments for a participant's lifetime. As a result, in Notice 2015-49, the IRS announced its intent to amend the RMD rules to prohibit, in most cases, changes to the annuity payment period for ongoing annuity payments from a defined benefit plan, including changes accelerating or providing an option to accelerate ongoing payments.

Notice 2019-18

In Notice 2019-18, the IRS stated that it no longer intends to amend the RMD rules in the manner that it earlier described in Notice 2015-49 (addressing the practice of defined benefit plans offering retirees and beneficiaries who currently are receiving annuity payments a temporary option to elect a lump-sum payment in lieu of future annuity payments). The IRS stated that Treasury Department and IRS will continue to study the issue of retiree lump-sum windows. Until further guidance is issued, the IRS stated that it will not assert that a plan amendment providing for a lump-sum window program causes a plan to violate the RMD rules. IRS will continue to evaluate whether such a plan, as amended, violates nondiscrimination rules and other benefits tax requirements of the Internal Revenue Code. During the period of study, the IRS will no longer issue private letter rulings concerning retiree lump-sum windows. However, if a taxpayer is eligible to apply for and receives a determination letter (concerning the form of a plan document), the IRS will no longer include a caveat expressing no opinion regarding the tax consequences of such a window in the letter.

Next steps

Plan sponsors should exercise caution before amending their plan documents to provide for lump-sum windows to retirees and beneficiaries who currently are receiving annuity payments. Prior to making any plan design changes, sponsors should consult with their legal counsel.

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