



IRS limits certain lump sum payments

On July 9, 2015, the IRS announced in [Notice 2015-49](#) that it intends to amend the required minimum distribution rules to provide that as of July 9, 2015, defined benefit plans are generally not allowed to replace any annuity payments being paid by a qualified defined benefit plan. The amended regulations will provide that qualified defined benefit plans are not permitted to replace any joint and survivor, single life or other annuity currently paid with a lump sum payment or other accelerated form of payment.

Background

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.

During the past several years, defined benefit plan sponsors have amended their plans, under the [plan amendment exception](#), to provide a limited period ("window period") during which retirees who are receiving annuity payments are offered a one-time opportunity to convert that annuity into a lump sum that is immediately payable. These arrangements are referred to as "lump sum risk-transferring programs" because the longevity risk and investment risk are transferred from the plan to the retirees. The IRS has issued several private letter rulings which approve these lump sum risk transfer arrangements.

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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.

The IRS has also concluded that permitting lump sum payments to replace ongoing annuity payments is 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.

The Notice does not provide guidance regarding federal tax consequences of a lump sum risk-transferring program. It is also unclear whether the Notice restricts lump sum payments at plan termination for retirees receiving annuity payments.

Effective date

The amendments to the RMD rules will be effective as of July 9, 2015. However, the amendments will not apply to an acceleration of ongoing annuity payments that is in association with a plan amendment specifically providing for a lump sum risk-transferring program:

- Adopted (or specifically authorized by a board, committee, or similar body with authority to amend the plan) prior to July 9, 2015;
- With respect to which a private letter ruling or determination letter was issued by the IRS prior to July 9, 2015;
- With respect to which a written communication to affected plan participants stating an explicit and definite intent to implement the lump sum risk-transferring program was received by those participants prior to July 9, 2015; or
- Adopted pursuant to an agreement between the plan sponsor and an employee representative (with which the plan sponsor had entered into a collective bargaining agreement) specifically authorizing implementation of a lump sum risk transferring program that was entered into and was binding prior to July 9, 2015.

Private letter rulings or determination letters

Any private letter ruling or determination letter issued by the IRS involving a plan that provides for a lump sum risk-transferring program will generally include a statement expressing no opinion as to the federal tax consequences of the program.

Next steps

Although the IRS has indicated that it intends to amend the RMD rules, the Notice does not indicate timing as to when the amended rules will be published. However, when published, the amended rules are retroactive to July 9, 2015. Prudential Retirement will provide additional information when the IRS publishes the amended rules.

While plan sponsors cannot offer lump sum payments to retirees who are receiving annuities, lump sum windows can still be offered to deferred vested participants who have not yet commenced payments.

Plan sponsors should consult with their legal counsel or their plan's enrolled actuary if they have questions about this recent IRS notice.

Compliance Advisory by Prudential Retirement

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