IRS Notice on Lump-Sum Windows for Retirees Creates More De-Risking Opportunities

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On March 6, the IRS issued Notice 2019-18, reversing its previous position that offering a lump-sum option to participants in pay status during a one-time "window" violates Internal Revenue Code section 401(a)(9). Notice 2019-18 supersedes Notice 2015-49, where the IRS expressed its intent to amend the minimum required distribution ("MRD") regulations to prohibit amendments to qualified defined benefit plans permitting participants in pay status to commute the remaining value of their annuity payments to a lump-sum payment during such a window.

Notice 2019-18 is a surprising reversal that enhances the menu of "de-risking" opportunities for defined benefit plan sponsors. We review Notice 2019-18 and provide some background below.

Background

The MRD regulations generally provide that, once pension annuity payments begin, they cannot be changed and must be "non-increasing." One exception allows annuity payments to increase if the payment of increased benefits results from a plan amendment. In a series of private rulings issued before Notice 2015-49, the IRS ruled that this exception applied to a plan amendment implementing a lump-sum window feature, provided certain requirements were met. In light of these rulings, it appeared that defined benefit plans could offer retirees a temporary one-time election to receive their remaining benefit in a lump sum (often referred to as a "window") without violating the MRD rules.

While plan sponsors welcomed this concept, pension rights advocates and senior citizen groups did not – primarily on the basis of concern that retirees may outlive their income. Notice 2015-49 announced the IRS' intent to amend the MRD regulations to provide that an amendment accelerating annuity payments (such as a retiree lump-sum window) was not within the "increase in benefits" exception, effectively prohibiting this type of de-risking amendment. In its explanation, the IRS indicated that offering retirees the right to accelerate distributions would not be allowed.

Notice 2015-49 also expressly provided that any private letter ruling or determination letter issued by the IRS would generally include a caveat expressing no opinion as to the federal tax consequences of a retiree lump-sum window.

The Latest IRS Notice

Notice 2019-18 announces that the IRS no longer intends to amend the MRD regulations to prohibit retiree lump-sum windows, but will continue to study the issue. Importantly, until further guidance is issued, the IRS will not assert that an amendment providing for a retiree lump-sum window will cause a plan to violate Code section 401(a)(9). The Notice states that the IRS will continue to evaluate whether such a plan amendment continues to satisfy other Code sections – including 401(a)(4) (nondiscrimination rules), 411 (non-forfeiture requirement), 415 (benefit limitations), 417 (spousal protections), and 436 (funding-based benefit restrictions). Not surprisingly, given the IRS' limited resources, the Notice also states that the IRS will not issue private letter rulings on retiree lump-sum windows. However, for a plan sponsor who is eligible to seek a determination letter, the letter will no longer include a caveat expressing no opinion on the tax consequences of a retiree lump-sum window.

Observations

The IRS appears to have re-opened the door for retiree lump-sum windows. In light of this change, some plan sponsors may wish to evaluate this alternative to the annuitization of benefits currently being paid from the plan's trust. (See our February 12 alert on the latter strategy.) Both strategies remove longevity and investment risks, as well as saving significant PBGC premiums.

Plan sponsors should carefully consider the possibility of further guidance from the IRS on retiree lump-sum windows, as well as many other Code provisions that may be implicated by offering this feature, including the provisions referenced in Notice 2019-18. Plan sponsors also will want to consider numerous other administrative complexities such as QDROs, how retiree medical premiums are being paid, etc. And the IRS is not the only agency that has expressed interest in de-risking activities. Thus, plan sponsors should also consider the PBGC and Department of Labor implications of adding a retiree lump-sum window. In particular, sponsors should ensure that all participant communications are as clear and comprehensive as possible – an area where legal and HR specialists may have different perspectives. Still another wild card revolves around possible legislative or other renewed efforts by retiree groups to stop the practice.

Groom attorneys assisted numerous sponsors in navigating the lump-sum strategy before the 2015 restrictions and we have been working with clients on annuitization and other strategies since then. Please do not hesitate to reach out to your favorite Groom lawyer if you are considering any of these or other "de-risking" options.