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## LEGAL DEVELOPMENTS



# *Lump Sum Windows for Retirees Back in Play*

*It appears that the Internal Revenue Service has decided to allow benefit plans to offer lump sum payments after effectively eliminating that option with Notice 2015-49 in 2015.*

BY ELIZABETH THOMAS DOLD

**Elizabeth Thomas Dold** is a principal attorney at Groom Law Group, Chartered in Washington, DC. For nearly 20 years, her work has focused on employee benefits and compensation matters, including employment taxes and related reporting and withholding requirements. She regularly advises Fortune 500 companies (including corporate and tax-exempt employers, financial institutions, and third-party administrators) on plan qualification and employment tax issues. Ms. Dold is a past Chairperson of the Information Reporting Program Advisory Committee and a former adjunct professor at Georgetown Law Center.

For years, plan sponsors of defined benefit plans have been undertaking various strategies to align the plan benefits due with the plan assets, so-called de-risking opportunities. One popular strategy is to temporarily offer a lump sum distribution to participants, which removes the ongoing liability from the plan (and eliminates costly Pension Benefit Guaranty Corporation premiums). This is commonly referred to as a "lump sum window."

Initially, following the two key private letter rulings in this area issued in 2012, these lump sum windows extended to retirees in pay status. In 2014, the Internal Revenue Service (IRS) again issued a line of similar rulings in 2014 in relation to plan amendments that permitted a retiree in pay status to convert his or her annuity to a lump sum benefit. But all that changed in 2015, when the IRS issued Notice 2015-49, which effectively eliminated this effective de-risking strategy going forward by stating that it violates the minimum requirement distribution requirements under Section 401(a)(9) of the Internal Revenue Code of 1986, as amended (Code). Now, nearly four years later, the IRS has issued Notice 2019-18 (Notice), which supersedes the 2015 notice and provides, until further guidance, that the IRS will not assert a Code Section 401(a)(9) violation as a result of a plan amendment to offer lump sums to retirees. So, for now, retiree lump sum windows are back in play!

A summary of the Notice is set forth below, followed by a review of lump sum windows and what to consider if one is implemented.

## Code Section 401(a)(9) Background

First, the Notice summarizes the required minimum distribution (RMD) rules under Code Section 401(a)(9), which provide for the latest date on which distributions must begin from a qualified plan, and how those distributions must be taken. In general, the Code and related regulations provide that a distribution from a defined benefit plan must be in the form of a periodic annuity payment for the life of the employee or the joint lives (or life expectancies) of the employee and his or her beneficiary. The regulations prohibit any change in the period or form of the distribution after it has commenced, unless an exception applies. One such exception is that the annuity payments may increase "[t]o pay increased benefits that result from a plan amendment." The regulations also expressly permit annuity payments to increase "to allow a beneficiary to convert the survivor portion of a joint and survivor annuity into a lump sum upon the employee's death." However, there was no similar rule permitting conversion of an employee's annuity benefit during an employee's life or conversion of a beneficiary's annuity other than upon the employee's death. [See Treas. Reg. §1.401(a)(9)-6]

## Notice 2015-49

Next, the Notice reviews the history of Notice 2015-49. It states that a number of plan sponsors were amending their defined benefit plans to provide a limited period during which certain retirees who were currently receiving lifetime annuity payments could elect to convert their annuities into lump sum payments that were immediately payable, *i.e.*, retiree lump sum windows. This approach was based on the view that the plan amendment to add this lump sum payment option was an increase in benefits, as permitted under the RMD regulations noted above.

On July 9, 2015, the IRS issued Notice 2015-49, which informed plan sponsors that the IRS was intending to issue new proposed 401(a)(9) regulations that would expressly provide that giving a participant currently receiving annuity payments the right to convert those payments into an immediate lump sum or other accelerated payment would not be treated as a payment of increased benefits. As a result, the providing of a lump sum window to these employees would raise a plan qualification concern. Notice 2015-49 explained that, although the RMD rules were intended to ensure that a distribution of the employee's benefit was not unduly tax-deferred, if an employee has the ability to accelerate annuity distributions at any time, then the actuarial cost associated with that acceleration right would result in smaller initial benefits, which would contravene the purpose of Code Section 401(a)(9).

The Notice provided for a July 9, 2015, effective date for this new interpretation, with a limited exception for plan sponsors that already had undertaken specific concrete steps with respect to the lump sum window (*e.g.*, participant communications or adoption of a plan amendment). Notably, the 2015 Notice also provided that no more private letter rulings would be issued as to the federal tax consequences of a retiree lump sum window, nor would determination letters express an opinion on such de-risking design.

## Retraction of Intent to Issue RMD Proposed Regulations

Third, and most important, the Notice specifically provides that the Treasury Department and IRS no longer intend to propose the changes to the RMD regulations that were described in the 2015 Notice, and that Notice 2015-49 is superseded. However, the Notice provides that the IRS will continue to study the issue of retiree lump sum windows. Nonetheless, until further guidance is issued, the IRS will not assert that a plan amendment providing for a retiree lump sum window program causes the plan to violate Code Section 401(a)(9), but will continue to evaluate whether the plan, as amended, satisfies the requirements of Code Sections 401(a)(4) (nondiscrimination testing), 411 (nonforfeiture), 415 (limit on benefits), 417 (QJSA rules), 436 (restrictions on lump sums), and other sections of the Code. Notably, the Notice expressly provides that the IRS is not re-opening its private letter ruling program with regard to these retiree lump sum windows. But, if the plan sponsor is eligible to apply for a determination letter, the IRS will no longer include a caveat in the letter expressing no opinion regarding the tax consequences of such a window in the letter.

This Notice does come after various trade organizations challenged the underlying legal basis for the RMD interpretation, along with the policy behind taking away a retiree's options. Moreover, it comes on the heels of the Treasury Department's issuance of a policy statement on the tax regulatory process that generally provides for law changes through the regulatory process (which is subject to notice and comment), and not through sub-regulatory guidance (including IRS Notices). Furthermore, the policy statement expressly provides that all future IRS Notices that announce intent to issue proposed regulations will include a statement that, if no proposed regulations or other guidance is released within 18 months after the date such a notice is published, taxpayers may continue to rely on the Notice but, until additional guidance is issued, the Treasury Department and the IRS will not assert a position adverse to the taxpayer based in whole or in part on the Notice.

**So What Happens Now?**

While there are a wide variety of de-risking strategies available, it appears that, at least for now, retiree lump sum windows are back in the mix. We anticipate plan sponsors will take another look at this option in an effort to reduce costs (including PBGC premium savings). But remember: This option is not without its administrative complexities, which is evident by the laundry list of Code citations that the IRS noted above that will be implicated with such a window. Therefore, careful review of the population to be included, the drafting of the plan amendment, and the participant communications and election materials, in light of the various legal requirements to be satisfied, is justified. And, to the extent a determination letter is not available to provide plan qualification protection, obtaining an opinion of counsel may well be in order. ■