

# One Minute Memo®



## IRS Moves to Limit De-Risking Lump Sum Distributions

*By Durward James Gehring*

On July 9, 2015, the IRS announced that it intends to amend the required minimum distribution regulations under Section 401(a)(9) of the Internal Revenue Code to prohibit plans from offering voluntary lump-sum cashouts to retirees who are already in pay status as part of a plan de-risking program. The new rules would apply to most lump-sum cashouts occurring after July 9.

In recent years, many sponsors of defined benefit pension plans have undertaken de-risking strategies in response to increasingly stringent minimum funding requirements, low interest rates and ever-rising Pension Benefit Guaranty Corporation premiums. One of the most common de-risking strategies is to offer participants an optional lump-sum buyout of their benefit in order to get them out of the plan. While many of these programs have been limited to deferred vested participants, some plan sponsors have also offered a buyout to retirees receiving monthly annuity payments.

One issue that is raised when a lump sum offer is made to retirees is whether conversion of an annuity to a lump-sum violates the minimum distribution rules, which generally provide that annuity payments must not increase after payment has commenced. When Ford and General Motors began the modern de-risking era by offering lump sum buyouts to their in-pay retirees, they obtained IRS private letter rulings that offering lump sum buyouts would satisfy one of the exceptions to the rule against increasing annuity payments, and would therefore be permissible under Section 401(a)(9). The IRS subsequently issued several identical letter rulings, and the general understanding has been that lump sums can be offered either to deferred vested participants, retirees, or both.

Now the IRS has reconsidered the issue, and announced that it intends to amend the minimum distribution rules to prohibit cashouts of annuities after payment has commenced. IRS Notice 2015-49 states the new regulations will apply to all cashouts after July 9, 2015, unless the plan sponsors had taken certain actions prior to July 9, such as adopting a board resolution, applying for a private letter ruling, or giving notice to participants. Cashouts pursuant to a binding collective bargaining agreement amended prior to July 9 will also be permitted.

Lump sum buyouts offered to deferred vested participants who have not yet commenced payment are not affected by the Notice. In addition, the Notice does not affect annuitization of benefits through the purchase of paid-up annuity contracts, another popular de-risking strategy.

Notice 2015-49 appears to represent an attempt by the government to slow down the de-risking juggernaut, which is rapidly leaving the PBGC in the position of primarily insuring plans that cannot afford to implement de-risking programs. The Department of Labor has also expressed concern regarding the sufficiency of disclosures to participants eligible for lump sum buyouts. The Notice itself has no legal effect, but alerts plan sponsors that if they offer lump sum buyouts to retirees after July 9, they do so at the risk of having the plan disqualified.

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