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IRS Puts Brakes on Pre-Plan Termination Retiree Cashout Windows

Notice 2015-49 announces that IRS will soon propose amendments to the minimum distribution regulations to bar “risk-transferring” transactions that offer cashouts to retirees who are already receiving annuities. The notice does not affect cashout windows for vested terminees who have not yet begun annuity payments and does not appear to affect the ability to offer distribution option changes because of the limited circumstances specified in the regulation, such as upon plan termination. Certain Pre-Notice Accelerations already underway on July 9, 2015 can be completed.

Background

Many defined benefit plan sponsors have created opportunities under their plans for vested terminees and retirees to consider alternatives to benefit distribution options ordinarily available under the terms of the plan. These are typically offers of lump sum cashouts during limited window periods. See our [August 27, 2012](#) and [April 23, 2014](#) *For Your Information* articles for more information on technical issues and challenges presented when considering these offers.

For retirees who are already in pay status, there had been a concern that certain limitations under the IRS minimum distribution rules would prevent a plan from offering lump sums to participants in pay status unless the plan was being terminated. However, some IRS private letter rulings issued beginning in 2012 clarified that plan amendments allowing retirees to elect to receive a lump sum settlement of the remainder of their annuity benefits during a window period would not violate the IRS minimum distribution rules because the cashouts would meet the regulatory exception for “paying increased benefits resulting from a plan amendment.”



The move toward offering lump sums to retirees has not been without detractors. Concerns have been raised about the ability of individuals to manage their pension funds and avoid ruin due to investment and longevity risks. In January 2015, the US Government Accountability Office issued a [report](#) critical of the disclosures provided to participants who are offered lump sum options.

Regulation Will Be Changed

In [IRS Notice 2015-49](#), IRS has announced its intent to propose revisions to the minimum distribution regulation to clarify that the exception for payments resulting from amendments to increase benefits will apply only to those that increase the amount of ongoing annuity payments (but not amendments that *accelerate* those payments). This will shut the door on offering lump sums to participants who are already in pay status.

The notice specifically says that they plan to amend the part of the regulation (Question 14) that was interpreted to allow distributions on account of plan amendments to increase benefits. The notice does not assert that they will modify the reannuitization exceptions in Question 13 — such as plan termination, actual retirement after in-service commencement, and converting to a qualified joint and survivor annuity in connection with getting married. It appears these triggers for a change in optional form will continue to be available.

Comment. There is some ambiguity in the notice about whether these exceptions will continue in current form. Plan sponsors should confer with counsel before amending plans to add these reannuitization options if they are not currently available.

Effective Date and Exceptions

The notice says that the revisions to the regulation will be effective immediately — July 9, 2015. Recognizing that some plan sponsors have already committed to lump sum offers for retiree groups, the notice provides an exception for amendments to allow an acceleration of ongoing annuity payments in any of the following situations:

- The amendment was adopted (or specifically authorized by a board, committee or similar body with authority to amend the plan) before July 9, 2015.
- The IRS issued a private letter ruling or determination letter on the program before July 9, 2015.
- A written communication was received by affected plan participants before July 9, 2015 that stated an explicit and definite intent to implement a lump sum risk-transferring program.
- The amendments were adopted pursuant to a collective bargaining agreement in effect before July 9, 2015.

In Closing

It is not surprising that IRS is trying to hold the line on retiree cashouts in response to concerns that have been raised in defense of retirees who may not fully understand the long-term ramifications of taking a lump sum. Comments on the merits of a change to the proposed regulation will likely challenge the notion that accelerating payments rather than continuing deferral could in any way circumvent the requirements of the minimum distribution rule. The end result is difficult to predict. However, given that most employers who have offered these windows have limited eligibility to participants whose benefits are not yet in pay status in light of concerns over anti-selection, the impact of changing the regulation should be minimal.

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