KPMG

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Notice 2019-18: Lump-sum payments instead of future annuity payments (defined benefit plans)

The IRS today released an advance version of Notice 2019-18 stating that the U.S. Treasury Department and IRS no longer plan to amend the required minimum distribution regulations under section 401(a)(9) with respect to the practice of offering retirees and beneficiaries who are currently receiving annuity payments under a defined benefit plan, a temporary option to elect a lump-sum payment in lieu of future annuity payments.

Read **Notice 2019-18** [PDF 40 KB]

Background

Section 401(a)(9) prescribes required minimum distribution rules for a qualified plan under section 401(a).

If the employee's entire interest is not distributed by the required beginning date, section 401(a)(9)(A) provides that the entire interest must be distributed—beginning not later than the required beginning date—over the life of the employee or lives of the employee and a designated beneficiary (or a period not extending beyond the life expectancy of the employee or the life expectancy of the employee and a designated beneficiary).

Reg. section 1.401(a)(9)-6, A-1(a) provides that, absent an applicable exception, in order to satisfy the section 401(a)(9) rule, distributions of an employee's entire interest under a defined benefit plan must be paid in the form of periodic annuity payments for the employee's or beneficiary's life (or the joint lives of the employee and beneficiary) or over a certain period that is no longer than a period permitted under the regulations. The period is approximately equal to the joint and last survivor life expectancy of the employee and an assumed beneficiary who is 10 years younger than the employee, with a longer period if the sole beneficiary is the employee's spouse and the spouse is more than 10 years younger. The regulations generally prohibit any change in the period or in the form of the distribution once it has commenced. However, if certain conditions are met, changes are allowed to the payment period after payments have commenced in association with an annuity payment increase.

The regulations also provide that periodic annuity payments cannot be non-increasing or may increase only as otherwise provided. For instance, annuity payments may be increased to pay increased benefits that result from a plan amendment, or to allow a beneficiary to convert the survivor portion of a joint and survivor annuity into a lump sum upon the employee's death. No similar rule is provided with respect to 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.

Reason for Notice 2019-18

The IRS observed that a number of sponsors of defined benefit plans have amended their plans to provide a limited period during which certain retirees, currently receiving lifetime annuity payments from those plans, may elect to convert their annuities into lump sums that are payable immediately. These arrangements are sometimes referred to as "retiree lump-sum windows."

Although the treatment under section 401(a)(9) of such a right to convert a current annuity into an immediate lump-sum payment has not been addressed explicitly in regulations or other guidance, the IRS noted that the addition of such a right to a plan has been treated in some instances as an increase in benefits (as described in Reg. section 1.401(a)(9)-6, A-14(a)(4)) with the result that the annuity payment period would be permitted to change under the regulations.

The IRS previously issued Notice 2015-49 to announce that Treasury and the IRS intended to propose amendments to the required minimum distribution regulations under section 401(a)(9) to address the use of lump-sum payments to replace ongoing annuity payments under a qualified defined benefit plan.

The planned amendments to the regulations would have provided that a lump-sum or other accelerated payment made pursuant to an amendment to a qualified defined benefit plan that affords a participant currently receiving annuity payments the right to convert those annuity payments into an immediate lump-sum or other accelerated payment would not be treated as a payment of increased benefits described in Reg. section 1.401(a)(9)-6, A-14(a)(4).

Thus, a retiree lump-sum window would not have been eligible for the Reg. section 1.401(a)(9)-6, A-13(a) exception—under which an annuity payment period may be changed in association with an annuity payment increase described in Reg. section 1.401(a)(9)-6, A-14.

Notice 2019-18 retracts intention for proposed regulations

Today's notice states that the Treasury Department and IRS no longer intend to propose the amendments to the regulations under section 401(a)(9) (as previously described in Notice 2015-49). However, the notice indicates that Treasury and the IRS will continue to study the issue of retiree lump-sum windows.

Until further guidance is issued, Notice 2019-18 states that the IRS will not assert that a plan amendment providing for a retiree lump-sum window program causes the plan to violate section 401(a)(9). Rather, the IRS will continue to evaluate whether the plan, as amended, satisfies the requirements of sections 401(a)(4), 411, 415, 417, 436, and other applicable Code sections.

During this evaluation period, as stated in today's notice, the IRS will not issue private letter rulings with regard to retiree lump-sum windows. However, if a taxpayer is eligible to apply for and receive a determination letter, the IRS will no longer include a caveat expressing no opinion regarding the tax consequences of such a window in the letter.

With today's release, Notice 2015-49 is superseded.

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