Notice 2015-49

Use of Lump Sum Payments to Replace Lifetime Income Being Received By Retirees Under Defined Benefit Pension Plans

I. PURPOSE

This notice informs taxpayers that the Treasury Department and the IRS intend to amend the required minimum distribution regulations under § 401(a)(9) of the Internal Revenue Code to address the use of lump sum payments to replace annuity payments being paid by a qualified defined benefit pension plan. The regulations, as amended, will provide that qualified defined benefit plans generally are not permitted to replace any joint and survivor, single life, or other annuity currently being paid with a lump sum payment or other accelerated form of distribution. The Treasury Department and the IRS intend that these amendments to the regulations will apply as of July 9, 2015, except with respect to certain accelerations of annuity payments described in section IV of this notice.

II. BACKGROUND

Section 401(a)(9) prescribes required minimum distribution rules for a qualified plan under § 401(a). In general, under these rules, distribution of each employee's entire interest must begin by the required beginning date. The required beginning date generally is April 1 of the calendar year following the later of (1) the calendar year in which the employee attains age 70½ or (2) the calendar year in which the employee retires. However, the ability to delay distribution until the calendar year in which an employee retires does not apply in the case of a 5-percent owner (as defined in § 416).

If the entire interest of the employee is not distributed by the required beginning date, § 401(a)(9)(A) provides that the entire interest of the employee must be distributed, beginning not later than the required beginning date, in accordance with regulations, over the life of the employee or lives of the employee and a designated beneficiary (or over a period not extending beyond the life expectancy of the employee or the life expectancy of the employee and a designated beneficiary). Section 401(a)(9)(B) prescribes required minimum distribution rules that apply after the death of the employee.

Section 1.401(a)(9)-6, A-1(a) provides that absent an applicable exception, in order to satisfy § 401(a)(9), distributions of an employee's entire interest 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 period certain that is no longer than a period permitted under § 1.401(a)(9)-6, A-3 or A-10, as applicable (which 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 prohibit any change in the period or form of the

distribution after it has commenced, except in accordance with § 1.401(a)(9)-6, A-13. If certain conditions are met, § 1.401(a)(9)-6, A-13(a) permits changes to the payment period after payments have commenced in association with an annuity payment increase described in § 1.401(a)(9)-6, A-14.

Section 1.401(a)(9)-6, A-1(a) also provides that the payments must be nonincreasing or may increase only as otherwise provided, such as permitted increases described in § 1.401(a)(9)-6, A-14. Section 1.401(a)(9)-6, A-14(a)(4) permits annuity payments to increase "[t]o pay increased benefits that result from a plan amendment." In addition, § 1.401(a)(9)-6, A-14(a)(5) permits 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," but 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.

The § 401(a)(9) provisions and related regulations regarding pension plan annuities were crafted to provide an administrable way to ensure that a distribution of the employee's benefit will not be unduly tax-deferred. For example, a pension plan cannot permit an employee who has passed the required beginning date to defer distribution of the bulk of the employee's benefit (and thus defer the tax) until later in life, while taking relatively small periodic benefits in the interim. In addition, under the regulations, a defined benefit pension plan cannot permit a current annuitant to commute annuity payments to a lump sum or otherwise accelerate those payments, except in a narrow set of circumstances specified in the regulations, such as in the case of retirement, death, or plan termination. See § 1.401(a)(9)-6, A-13(a) and (b). If a participant has the ability to accelerate distributions at any time, then the actuarial cost associated with that acceleration right would result in smaller initial benefits, which contravenes the purpose of § 401(a)(9).

A number of sponsors of defined benefit plans have amended their plans to provide a limited period during which certain retirees who are currently receiving joint and survivor, single life, or other life annuity payments from those plans may elect to convert that annuity into a lump sum that is payable immediately.[1] These arrangements are sometimes referred to as lump sum risk-transferring programs because longevity risk and investment risk are transferred from the plan to the retirees. For purposes of compliance with the requirements of § 401(a)(9), the addition of such a right to convert a current annuity into an immediate lump sum payment has been treated in some instances as an increase in benefits that is described in § 1.401(a)(9)-6, A-14(a)(4) (with the result that the annuity payment period would be permitted to change under § 1.401(a)(9)-6, A-13(a)).

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[1] *See* United States Government Accountability Office, "PRIVATE PENSIONS Participants Need Better Information When Offered Lump Sums That Replace Their Lifetime Benefits," GAO-15-74, http://www.gao.gov/products/GAO-15-74; Advisory Council on Employee Welfare and Pension Benefit Plans, "Private Sector Pension De-risking and Participant Protections," available at http://www.dol.gov/ebsa/pdf/2013ACreport2.pdf.

III. ANTICIPATED AMENDMENTS TO THE REGULATIONS UNDER SECTION 401(a)(9)

The Treasury Department and the IRS intend to amend the regulations under § 401(a)(9) that address the distribution of an employee's interest after the required beginning date. Those regulations reflect an intent, among other things, to prohibit, in most cases, changes to the annuity payment period for ongoing annuity payments from a defined benefit plan, including changes accelerating (or providing an option to accelerate) ongoing annuity payments. The Treasury Department and the IRS have concluded that a broad exception for increased benefits in § 1.401(a)(9)-6, A-14(a)(4) that would permit lump sum payments to replace rights to ongoing annuity payments would undermine that intent. Accordingly, the Treasury Department and the IRS intend to propose amendments to § 1.401(a)(9)-6, A-14(a)(4) to provide that the types of permitted benefit increases described in that paragraph include only those that increase the ongoing annuity payments, and do not include those that accelerate the annuity payments. The exception for changes to the annuity payment period provided in § 1.401(a)(9)-6, A-13 (as intended to be amended) would not permit acceleration of annuity payments to which an individual receiving annuity payments was entitled before the amendment, even if the plan amendment also increases annuity payments.

This notice does not provide guidance with respect to the federal tax consequences of a lump sum risk-transferring program under § 401(a)(4), 411, 415, 417, or 436, or any other section of the Code except for § 401(a)(9).

IV. EFFECTIVE DATE

The Treasury Department and the IRS intend that the amendments to the regulations under § 1.401(a)(9)-6 described in this notice will apply as of July 9, 2015. However, the Treasury Department and the IRS anticipate that the amendments to the regulations will not apply to an acceleration of ongoing annuity payments that is in association with a plan amendment specifically providing for implementation of a lump sum risk-transferring program: (1) adopted (or specifically authorized by a board, committee, or similar body with authority to amend the plan) prior to July 9, 2015; (2) with respect to which a private letter ruling or determination letter was issued by the IRS prior to July 9, 2015; (3) with respect to which a written communication to affected plan participants stating an explicit and definite intent to implement the lump sum risk-transferring program was received by those participants prior to July 9, 2015; or (4) adopted pursuant to an agreement between the plan sponsor and an employee representative (with which the plan sponsor has entered into a collective bargaining agreement) specifically authorizing implementation of such a program that was entered into and was binding prior to July 9, 2015. An acceleration of ongoing annuity payments that is in association with a plan amendment implementing a lump sum risk-transferring program that satisfies one of these four conditions is referred to in this notice as a "Pre-Notice Acceleration."

The IRS will not challenge the treatment of a Pre-Notice Acceleration as an increase in benefits that is described in the current § 1.401(a)(9)-6, A-14(a)(4) (which, as noted, permits annuity payments to increase to pay increased benefits that result from a plan amendment). Accordingly, in the case of a Pre-Notice Acceleration, the annuity payment period will be permitted to be changed under § 1.401(a)(9)-6, A-13(a).

V. PRIVATE LETTER RULINGS OR DETERMINATION LETTERS

In light of the pending guidance, any private letter ruling or determination letter issued by the IRS or the IRS Office of Chief Counsel involving a plan that provides for a lump sum risk-transferring program will generally include a caveat expressing no opinion as to the federal tax consequences of the lump sum risk-transferring program. However, the IRS and the IRS Office of Chief Counsel may determine that the addition of a right to make a Pre-Notice Acceleration is an increase in benefits that is described in the current § 1.401(a)(9)-6, A-14(a)(4). See section 6.09 of Rev. Proc. 2015-1, 2015-1 I.R.B. 1.

VI. DRAFTING INFORMATION

The principal authors of this notice are Michael P. Brewer and Thomas C. Morgan of the Office of the Associate Chief Counsel (Tax Exempt and Government Entities).