

IRS REGULATIONS PERMITS PARTIAL LUMP SUM DISTRIBUTIONS FROM DEFINED BENEFIT PLANS

T.D 9783

Hodgson Russ Newsletter

October 31, 2016

In many defined benefit plans a participant faces a difficult economic decision with respect to their retirement benefit. Defined benefit plans provide for an annuity stream of payments that will last for the participant life (and possibly joint lives with a spouse). Some defined benefit plans offer the participant the option of electing a lump sum benefit. This presents the participant with a difficult choice between these two options. The participant who takes a lump sum benefit may outlive the retirement income paid by the lump sum amount. Alternatively, an election of the annuity form of payment may not pay significant benefits if the participant (and spouse) die earlier than expected. The Internal Revenue Service (IRS) thought that permitting an election of partial lump sum distribution and partial annuity distribution could help participants who face this decision. The IRS has issued final regulations that make this easier for plans to offer this choice. Plans who pay a lump sum must pay a benefit calculated in accordance with certain factors set out under Internal Revenue Code (the “Code”) Section 417(e). Under prior regulations, it was unclear as to what was the proper method to comply with these requirements if only a portion of the benefit is being paid as a lump sum. These final regulations permit for bifurcation of the benefit and that the factors under Code Section 417(e) would only be applicable to the portion that is being paid at the lump sum. Additionally, for plans that have already offered a partial lump sum, special rules and relief from the anti-cutback requirements are provided if the plan is amended before December 31, 2017. In light of these new final regulations, plan sponsors may wish to examine whether a partial lump sum benefit feature may be a desirable feature to be added to a plan and to discuss with legal counsel and the plan’s actuary the requirements contained in the final regulations. (T.D. 9783)

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