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IRS Opens Window for Lump Sum Distribution Windows

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Defined benefit pension plans can be troublesome for sponsoring employers to maintain. The long-term liability for funding pension benefits coupled with unpredictable investment returns creates volatility. Companies interested in reducing their exposure to future funding obligations may be interested to hear that they now have another tool at their disposal. Recently the IRS issued a Notice that gave new life to an old de-risking strategy – lump sum distribution windows for retirees in pay status.

Offering participants the option of a lump sum distribution in lieu of a pension stream of payments reduces the plan's long-term liability in exchange for a short-term cash outlay. Lump sum distribution windows are commonly offered to “deferred vested” participants – those who have retired and are eligible for but have not yet started their benefits. But it has not always been clear whether they could be offered to retirees who are already receiving their annuities. The IRS issued two Private Letter Rulings in 2012 that indicated the practice was acceptable, and many plan sponsors conducted lump sum windows for retirees in pay status based on that guidance. But then in 2015, the IRS issued a notice denouncing its previous guidance and announcing that it would amend its regulations to prohibit the practice. The IRS's concern, ironically, was that the lump sum might be a prohibited increase of the payout amount. For the last few years, that Notice and the threat of upcoming regulation have had a chilling effect, causing pension plan sponsors to be reluctant to implement lump sum distribution windows for retirees in pay status. But the IRS never did issue the promised regulations, and in March 2019, the IRS reversed itself again. The IRS issued Notice 2019-19, announcing that lump sum windows to retirees in pay status are permissible.

There may still be other administrative or practical obstacles to offering lump sums to retirees in pay status, but at least the legal landscape is again open to the possibility. Pension plan sponsors interested in lump sum windows or other de-risking strategies can contact the Benefits Law Group.