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Final regulations: Benefit plans offering combination of single-sum payment and annuity

The Treasury Department and IRS today released for publication in the Federal Register final regulations (T.D. 9783) concerning the minimum present value requirements applicable to certain defined benefit pension plans.

The [final regulations](#) [PDF 268 KB] finalize amendments that were proposed in February 2012 with certain changes made in response to comments.

Reasons for regulations

The final regulations amend existing regulations under section 417(e) to allow plans to simplify the treatment of certain optional forms of benefit that are paid partly in the form of an annuity (that is, excepted from the minimum present value requirements of section 417(e)(3)) and partly in a more accelerated form.

As explained by the IRS and Treasury, when a defined benefit plan offered a single-sum distribution or other form of accelerated distribution as an optional form of benefit—in addition to the required qualified joint and survivor annuity—many participants were reluctant to elect lifetime payments to insure against unexpected longevity, and instead elected to take an accelerated distribution form in order to maximize their liquidity. Yet, participants who elected a single sum or other accelerated form of distribution possibly faced a greater challenge in protecting themselves against the risk of outliving their retirement savings.

To address these concerns, regulations were proposed in 2012 reflecting the belief that many participants would be better served by having the opportunity to elect to receive a portion of their retirement benefits in annuity form (thus providing financial protection against unexpected longevity) while receiving accelerated payments for the remainder of the benefit to provide increased liquidity during retirement. Under what

were the then-current regulations, both portions of such a distribution option were subject to the minimum present value requirements of section 417(e)(3).

Final regulations

The 2012 proposed regulations offered an exception to this rule for a plan with a bifurcated accrued benefit (as defined). Under this exception, the plan was permitted to provide that, if a participant selects two different distribution options with respect to separate portions of the bifurcated accrued benefit, then the two different distribution options are treated as two separate optional forms of benefit for purposes of applying the requirements of section 417(e)(3).

The final regulations combine the first two bifurcation approaches from the proposed regulations into what the preamble describes as a single, more broadly applicable rule. Under the rule in these final regulations, a plan is permitted to explicitly bifurcate the accrued benefit so that the plan provides that the requirements of Reg. section 1.417(e)-1(d) apply to a specified portion of a participant's accrued benefit as if that portion were the participant's entire accrued benefit. This rule does not impose any requirements with respect to the distribution options for the remaining portion of the accrued benefit.

An alternative rule is provided in the final regulations under which a plan that distributes a specified single-sum amount to a participant satisfies the requirements of Reg. section 1.417(e)-1(d) with respect to that payment, provided the remaining portion of the participant's accrued benefit satisfies a minimum requirement. The preamble explains that this rule is essentially the same as the third bifurcation approach from the proposed regulations. Under this alternative rule, the portion of the participant's accrued benefit, expressed in the normal form of benefit under the plan and commencing at normal retirement age (or at the current date, if later), that is not settled by the single-sum payment must be no less than the excess of: (1) the participant's total accrued benefit expressed in that form; over (2) the annuity payable in that form that is actuarially equivalent to the single-sum payment determined using the applicable interest rate and the applicable mortality table. Thus, the portion of the participant's accrued benefit that is settled by the payment of a specified single-sum amount is implicitly determined as the actuarial equivalent of that single-sum amount.

In response to comments, the final regulations further specify that if the amount of a distribution in an optional form of benefit to which Reg. section 1.417(e)-1(d) applies is determined by reference to the portion of a participant's accrued benefit as of the applicable amendment date, then the plan is not permitted to use the alternative rule under which the amount of the benefit that is settled by the single-sum payment is implicitly determined but could use the explicit bifurcation rule in order to avoid application of section 417(e) to both optional forms of benefit. The implicit bifurcation rule also is not available in a situation in which a single-sum distribution is available to settle a participant's entire accrued benefit and the plan permits a portion of the benefit to be paid as a lump sum.

Under the regulations, if a plan provides for an early retirement benefit, a retirement-type subsidy, an optional form of benefit, or an ancillary benefit, that applies only to a portion of a participant's accrued benefit, and the plan provides for an accelerated form of distribution that settles some, but not all, of the participant's accrued benefit, then the plan must specify which portion of the participant's total accrued benefit is settled by that distribution. The preamble states that this is necessary in order to determine the extent to which the early retirement benefit, retirement-type subsidy, optional form of benefit, or ancillary benefit applies with respect to the remaining portion of the accrued benefit.

As an example, if a plan had one set of early retirement factors that applied to the accrued benefit as of December 31, 2005, but a different set of early retirement factors that applied to benefit accruals earned after that date, and the plan provides for a single-sum distribution that settles only a portion of a participant's accrued benefit, then the plan must specify which portion of the accrued benefit is settled by that distribution (in order to determine which early retirement factors apply to the remaining portion of the accrued benefit).

The final regulations provide for limited section 411(d)(6) relief in the case of a plan that, for plan years beginning before January 1, 2017, uses the section 417(e)(3) applicable interest rate and applicable mortality table to calculate the amount of a distribution that is made to settle a portion of the accrued benefit if, pursuant to these final regulations, the requirements of section 417(e)(3) need not apply to the distribution. Here, section 411(d)(6) is not violated solely because the plan is amended on or before December 31, 2017, to provide that the amount of the distribution is determined for an annuity starting date on or after the applicable amendment date using the same actuarial assumptions that would apply to calculate the amount of a distribution in that same form of benefit if the participant elected to receive the entire accrued benefit in that form.

The final regulations include a number of examples in order to illustrate the bifurcation rules of the regulations and the rules of operation with respect to these rules.

KPMG observation

The changes in the final regulations are intended to make it simpler and easier for a plan to offer an optional form of benefit that is a combination of a single-sum payment and an annuity. A plan applying a bifurcated approach is able to use the section 417(e)(3) assumptions for the single-sum portion of the optional form and its usual annuity equivalence factors for the annuity portion (rather than being required to make a special calculation of the annuity portion using the section 417(e)(3) assumptions). This treatment is not only simpler administratively, but is expected to yield a more intuitive result.

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