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US Treasury Final Regulations Clarify Partial Lump Sum Distribution Rules

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In September, the US Department of the ***Treasury*** issued final regulations that clarify the minimum present value requirements for defined benefit plans in order to simplify the rules associated with partial lump sum distributions. These new rules, which generally apply to distributions with annuity payments starting in plan years beginning on or after January 1, 2017, are intended to encourage plans to offer hybrid distribution options that include an annuity, to ensure a lifetime benefit stream.

Defined benefit pension plans are generally required to provide a participant’s accrued benefit in an annuity form of benefit as the normal form of payment. Many pension plans also offer optional forms of distribution, including lump sum payments, which are available with spousal consent (if applicable). Some plans offer optional forms of benefit that include a partial lump sum payment and an annuity stream. Lump sum distributions from pension plans are subject to minimum present value requirements, however, the application of such rules to bifurcated lump sum/annuity payments has not been clear.

The final regulations provide two approaches to bifurcating a participant’s accrued benefit under a plan so that the Internal Revenue Code section 417(e) minimum present value requirements apply only to the lump sum portion:

- Explicit Bifurcation Rule. A plan may split the accrued benefit to provide that the present value requirements apply to a portion of the benefit as if that portion were the entire accrued benefit. This is applied when the plan document identifies a specific portion of a participant’s accrued benefit that is settled when paid in a form subject to the minimum present value requirements.

- Implicit Bifurcation—Distribution of a Specified Amount. A plan that distributes a specified lump sum amount not described in the explicit bifurcation rule satisfies the present value requirements if the remainder of the participant's accrued benefit is no less than the excess of

    - the participant's total accrued benefit; over

    - the annuity that is actuarially equivalent to the lump sum amount (determined using the applicable interest rate and mortality table).

Plan sponsors of defined benefit plans that currently offer partial lump sum distributions will want to review their plans for compliance with the final regulations. Plan sponsors that have previously considered but rejected partial lump sum distributions due to lack of clarity on the present value requirements may want to revisit the design change.

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