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New limits on lump sums

In a move that caught some retirement planners by surprise, the IRS in July issued new rules restricting the availability of lump sum distributions from pension plans. In general, when one reaches retirement one has a choice between a stream of payments that will last for life (or for the joint lives of a married couple) or a single payment that is actuarially equivalent to that amount. The calculation of that payment is based upon life expectancy and an interest rate factor.

Beginning in 2012, some employers began offering lump sum distributions to retirees who already had begun to receive their pensions, as well as to those who were not yet in pay status. The object was to remove the liability for company balance sheets. It also reduces longevity risk for the employer, the chance that the retiree will live beyond what the actuaries predicted when the pension was funded. Initially, the IRS approved the move.

Not anymore. Subject to some narrow exceptions, from now on once a retiree begins receiving pension payments they may not be replaced by a lump sum distribution.

Interestingly, this news comes just as companies appear to be considering expanded offers of lump sums for pension cashouts for current workers. The IRS announced that new longevity tables won't be adopted until 2017. These are the tables used to determine how large a lump sum needs to be so as to be equivalent to the pension promise that it replaces. The new tables will show longer expected lives for retirees, which, in turn, will increase the size of the lump sum distributions.

Those who accept a lump sum distribution will most likely want to roll it over into an IRA, to avoid the immediate tax blow that otherwise would apply. The advice of financial professionals is a must in this situation.

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