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Employee Benefits Corner

Proposed Required Minimum Distribution Regulations Explain SECURE Act Changes (and More)

By Elizabeth Thomas Dold and David N. Levine

Since the enactment of the Setting Every Community Up for Retirement Enhancement Act of 2019 (“SECURE Act”), plan sponsors and record-keepers alike have been eagerly awaiting updated regulations to explain how the changes under the SECURE Act should be implemented. With the SECURE Act provisions generally effective in 2020 and plan amendment deadline generally the end of the 2022 plan year, the issuance of the proposed regulations is welcomed. With the regulations, however, come detailed rules on how to comply with what appears to be an even more complex regulatory scheme, now with two required beginning dates (“RBDs”) under a single plan, which depend on when the participant was born, and different death benefit rules depending on the type of plan and when payments to the participant commenced. With plan qualification and a 50% excise tax on participants on the line, the stakes are high to get compliance with these rules right.

Also notable is the fact that the regulations were entirely rewritten to eliminate the “question and answer” (“Q&A”) format, which after living with the Q&A format for over 20 years makes ascertaining the scope of the changes a difficult task. This proposed regulation package is set forth in 87 FR 10504 (February 24, 2022) and includes changes to the following regulations:

- Reg. §§1.401(a)(9)-0 through 1.401(a)(9)-9, which apply to 401(a) and 401(k) qualified plans, and thankfully the headings for these regulations remain unchanged;
- Reg. §1.408-8 for individual retirement accounts (“IRAs”), which largely track the qualified plan rules but with special rules for aggregating IRAs and spouses treating the IRA as their own;
- Reg. §1.403(b)-6(e) for 403(b) plans, which largely track the qualified plan rules but with special rules including aggregating 403(b)s to meet the required minimum distribution (“RMD”) requirements, although the Internal Revenue Service (“IRS”) asks for comments on whether this rule should be eliminated to better track the qualified plan rules;
- Reg. §1.457-6(d) for 457(b) plans, which generally track qualified plan rules;

- Reg. §54.4974-1 (and 54.4974-2 removed) regarding excise tax for missed RMDs, which have two automatic waivers of the excise tax in certain situations; and
 - Reg. §1.402(c)-2 (and 1.402(c)-3 removed) to update the regulations for the SECURE Act changes and other guidance over the past 20 years, and which clarify how RMD rules interplay with the rollover rules (as RMD payments are not eligible for rollover).
- The highlights of the changes are set forth below, which are set to become effective from January 1, 2022. Importantly, the IRS has granted us a reasonable, good faith compliance standard for 2021 (and for 2020 we have the waiver of the rules), so that helps us focus on 2022 RMD payments, which should comply with these proposed regulations.

I. Defined Benefit Plan Changes

The following key changes are important to consider:

- *Required Beginning Date:* The SECURE Act changed the RBD for participants who are born on or after July 1, 1949 from age “70½” to age “72” years. Therefore, the participant’s RBD is April 1 of the calendar year following the later of (1) the calendar year in which the employee attains age 72 years (age 70½ years, if born before July 1, 1949) or (2) the calendar year in which the employee retires from employment with the employer maintaining the plan. Part (2) does not apply to a 5% owner. This change is not optional.

The proposed regulations previously allowed a plan to have a RBD based solely on age (not the later of age or retirement, without regard to whether the participant was a 5% owner). This rule was retained, so that a plan sponsor can have a RBD of April 1 of the calendar year following the calendar year in which the employee attains age 72 years (age 70½ years, if born before July 1, 1949), but cannot simply have a RBD for all participants of April 1 of the calendar year following the calendar year in which the employee attains age 70½ years. Unfortunately, there was no discussion in the preamble to the regulations regarding any concerns with anti-cutback violations for making this change and potentially eliminating an in-service withdrawal right. (Although the SECURE Act did contain broad anti-cutback relief, which was not changed by the proposed regulations.)

- *Actuarial Adjustment Post 70½.* The existing IRS regulations require an actuarial adjustment (under Code Sec. 401(a)(9)(C)(iii)) of a plan benefit that is delayed past age 70½ years where a participant continues to work. The regulations confirm that no

change has been made to this provision, and therefore even though other references to age “70½” years were changed under the SECURE Act, no change was intended or made herein. The regulations also clarify that this actuarial adjustment does not apply to 5% owners. Therefore, it is worth checking with the plan actuaries to see if any changes to the plan benefits are needed as a result of the RBD change.

- *Calculation of RMD amounts.* The lifetime RMD payments are largely unchanged by the proposed regulations—Reg. §1.401(a)(9)-6 continues to explain how annuity payments meet the RMD rules, and the special rules for non-increasing amounts. A few non-SECURE Act changes were made to certain annuity provisions, largely intended to slightly relax some of the rules, but for the most part, it is business as usual. Similarly, the post-death rules largely remain unchanged, maintaining the options (with the life expectancy and five-year option) that have been available to beneficiaries for years. The regulations also provide some helpful relief from RMD compliance where the beneficiary payments are restricted due to Code Sec. 436(d).

II. Defined Contribution Plans

The following key changes are important to consider:

- *Required Beginning Date:* As noted above, the SECURE Act changed the RBD for participants who are born on or after July 1, 1949 from age “70½” years to age “72” years. Therefore, the participant’s RBD is April 1 of the calendar year following the later of (1) the calendar year in which the employee attains age 72 years (age 70½ years, if born before July 1, 1949) or (2) the calendar year in which the employee retires from employment with the employer maintaining the plan. Part (2) does not apply to a 5% owner. This change is not optional.
- *Calculation of RMD amounts during participant’s lifetime:* The SECURE Act did not change the calculation method for determining RMD payments, and therefore the proposed regulations largely track the prior rules regarding how to calculate the RMD amount, although it is notable that annuities with a non-eligible designated beneficiary (“non-EDB”) that are available to a participant under the plan may need to be reconsidered, as lifetime payments to those beneficiaries are no longer available (as explained below).
- *Calculation of RMD amounts after the participant’s lifetime:* The SECURE Act made a number of changes to these rules, which largely limit the ability to stretch

plan benefits to beneficiaries. The rules still depend on whether a participant dies before or after reaching their RBD, as the historic “at least as rapidly” rule still applies (as clarified in the proposed regulations). And a new limitation is added to largely replace the five-year rule for designated beneficiaries with a similar 10-year rule (which applies in addition to the “at least as rapidly” rule).

Only the following EDBs are permitted to have payments paid over their lifetime following the participant’s death:

- surviving spouse of the participant,
- child of the participant who has not yet reached the age of majority (which the proposed regulations simplified to be age 21 years, regardless of applicable state law) (special rules apply),
- disabled (as defined under the regulations with detailed documentation requirements for the plan administrator) (including a related trust),
- chronically ill (as defined under the regulations with detailed documentation requirements for the plan administrator) (including a related trust), and
- individual not more than 10 years younger than the participant.

These beneficiaries may alternatively elect the 10-year rule—meaning payments are made within 10 years following the participant’s death. For all other designated beneficiaries, they must take the death benefits under the 10-year rule. The five-year rule continues to apply for estates, charities, and trusts (unless qualify as a look-through trust).

Notably, the IRS retained the look-through trust rules but added additional complexities regarding reviewing the trust documents and ascertaining the designated beneficiaries. There are also complexities with multiple beneficiaries, which the existing separate account rules may help address (which have been retained).

The default rules (unless the plan provides otherwise) are also new: lifetime payment for EDBs, 10-year rule for non-EDBs, and five-year rule if no designated beneficiary. For example, the regulations permit a plan document to (1) provide that the 10-year rule (and not the life expectancy rule) applies to some/all EDBs, or (2) give the participant or EDB the option to make an irrevocable election (subject to certain timing rules) between the 10-year rule or life expectancy rule, and include a default in the plan in the event no election is made.

But if the participant died on or after reaching their RBD, the following additional rules apply. The RMD payment is calculated using the longer of the participant’s or beneficiary’s life expectancy, as under the old rules. However,

there is a new hard stop to the payment. Specifically, the plan benefit must be paid in full by the earliest of: (1) for a non-EDB, the end of the 10th calendar year following the calendar year in which the participant died, (2) for an EDB (not the participant’s minor child and not older than the participant), the end of the 10th calendar year following the calendar year in which the EDB died, (3) for an EDB (participant’s minor child), the end of the 10th calendar year in which the beneficiary reaches the age of majority (age 21 years), and (4) for an older EDB, the end of the calendar year in which the applicable denominator would have been less than or equal to one if it were determined using the EDB’s remaining life expectancy rather than the participant’s remaining life expectancy. In light of the retained at least as rapidly rule, the annual payments must also continue to be paid during the 10-year period.

III. Other Changes

The proposed regulations update the rollover rules, and, importantly, explain when plan payments are treated as RMD payments and therefore not eligible for rollover treatment. They also update a few non-RMD items, such as the listing of amounts not eligible for rollover (to include deemed distributions with respect to “collectibles” pursuant to Code Sec. 408(m)) and the rules for property rollovers. The excise tax regulations are also updated, and include an automatic waiver of the 50% excise tax for a missed RMD payment that was due to be paid to the participant in the year of death, provided that it is paid out to the beneficiary no later than the beneficiary’s tax filing deadline (including extensions).

The devil is in the details, and with 275 pages of regulations, this is especially true with these proposed regulations.

IV. Action Steps

Plan sponsors should review with their recordkeeper/third-party administrator their RMD policies and procedures for compliance with the proposed regulations, which includes:

- timing of RMD payments and calculations of payments for the participant and the beneficiaries,
- review distribution packages and RMD letters,
- review rollover and reporting and withholding procedures for distributions, and
- consider updating plan documents and summary plan description (or summary of material modification) to reflect the new rules.

Stay tuned for any changes that come with the final regulations!

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