

IRS Revamps Minimum Required Distribution Rules

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At long last, the Internal Revenue Service issued proposed regulations under Code section 401(a)(9) that take into account the major changes made by the Setting Every Community Up for Retirement Enhancement Act of 2019 (“SECURE Act”), and make other conforming changes to the eligible rollover rules. 87 Fed. Reg. 10504 (February 24, 2022). These regulations impact the calculation of minimum required distributions (“MRDs”) from qualified plans, IRAs, tax-deferred annuities under Code section 403(b) (“TDAs”), and governmental 457(b) plans.

The 275 pages of proposed regulations revamp the current regulations – issued nearly 20 years ago – to eliminate the question and answer format. While most of the MRD rules generally remain the same, there are plenty of changes and a number of examples to help illustrate the rules. Compliance with these rules will pose challenges of every type – communications, system redesign and plan documentation to name the major ones.

Three Key Takeaways for Plan Sponsors

- Compliance with the proposed regulations is generally required for 2022, with reasonable, good faith for 2021 – with plan amendments made by year-end for most plans (unless IRS chooses to extend).
- Despite changing the required beginning date age to 72, for defined benefit plans, the proposed regulations do not make changes to when actuarial increases must apply (that continues to be at age 70½), nor do the proposed regulations address fairly common age 70½ in-service withdrawal provisions.
- The new 10-year payment rule to beneficiaries will add more complexity to the minimum required distribution process for plans, including that beneficiaries of participants who die after a participant has commenced their MRDs must receive annual payments under the life expectancy rule (“at least as rapidly”) AND receive all amounts within the 10-year period.

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The following summary highlights the major changes. Numerous issues and questions will arise as the pension community works with the proposed rules.

1. Changes Affecting All Plans/IRAs

Section 114 of the SECURE Act changed the definition of the “required beginning date” (RBD) age from age “70½” to age “72” for participants that are born on or after July 1, 1949, which is reflected in § 1.401(a)(9)-2 of the proposed regulations. A few items to note from the proposed regulations, particularly for defined benefit plans:

- They continue to allow plan sponsors to use a uniform RBD based solely on age (i.e., not impacted by when the participant retires), regardless of 5% owner status.
- They do not provide for an option to use an age 70½ RBD for all participants.
- They do not restrict the broad anti-cutback relief set forth in Section 601 of the SECURE Act regarding implementation of the SECURE Act changes.
- For plans that allow in-service distributions at age 70½ (including plans with a RBD of age 70½), they are silent about whether such plans must retain the in-service distribution option at 70½ in order to address anti-cutback concerns.

2. Changes Primarily Affecting DB Plans

While Section 114 of the SECURE Act changed the age “70½” reference for RBD determinations, it did not change a similar age “70½” reference under Code section 401(a)(9)(C)(iii) that requires an actuarial increase from age 70½ until the participant retires for those working past age 70½. The proposed regulations (§ 1.401(a)(9)-6) confirm this position, and clarify that this adjustment does not apply to a 5% owner, nor does it apply to governmental or church plans.

The proposed regulations (§ 1.401(a)(9)-6) also make technical changes to the existing rules for defined benefit plans, including: (1) adding a rule that the annuity contract must be issued by an insurance company licensed in the jurisdiction where the annuity is sold (not applicable to 403(b)(9) accounts which may self-insure in any event), (2) expanding the exceptions to the “non-increasing annuity payment” rule for resumption of benefits following certain suspensions (§§ 411(a)(3)(B), 418E, 432(e)(9)), and (3) modifying the exceptions under which payments from annuity contracts from insurance companies may increase by (a) providing that the total value is calculated as of the date on which the contract is annuitized instead of when annuity payments commence, and (b) adding three examples of permissible increases for a final payment on death that does not exceed the excess of total value being annuitized over the total payments before the death of the participant, a short-term acceleration of payments of up to one year, and acceleration to meet these new MRD rules.

The proposed rules also provide some helpful relief from MRD compliance where the MRD beneficiary payments are restricted under Code section 436(d), relating to materially underfunded plans.

3. Changes Primarily Affecting DC Plans/IRAs

The proposed regulations highlight the additional complexity defined contribution plans and IRAs will experience in implementing the changes from Section 401 of the SECURE Act such as by limiting “stretch IRAs”. Additionally, the Treasury and IRS included very detailed rules related to identifying the beneficiaries under trusts for MRD purposes, to move away from addressing those issues in private letter rulings and comment letters as has been common in the past.

While the proposed regulations generally carried over current guidance, significant additions to the rules include clarifying the types of beneficiaries and who is an “eligible designated beneficiary” (EDB), as well as how and when the new 10-year payment rule applies to various beneficiaries. And, unfortunately, the rules for MRDs still vary depending on whether or not the participant dies before or after their RBD. These rules are generally effective for participants who die after December 31, 2019 (or participants who die on and after January 1, 2022, for governmental plans and plan subject to a collective bargaining agreement).

A. Beneficiaries

Under the new MRD rules, it is important to distinguish between a nondesignated beneficiary, designated beneficiary, and eligible designated beneficiary for two primary reasons. First, the MRD payment-timing rules for the types of beneficiaries are different. Second, if the participant has a non-eligible designated beneficiary, then it is possible that no other beneficiaries are treated as an eligible designated beneficiary, which can require amounts to be paid out to beneficiaries faster than would otherwise have been required. Fortunately, the proposed regulations retain the ability to apply the MRD rules separately to the interests of beneficiaries whose benefits are accounted for separately, which can limit the potential impact of a non-eligible designated beneficiary.

To be a “designated beneficiary”, the beneficiary must be an individual. If the participant has a beneficiary that is not an individual, such as a trust that is not considered a “see-through” trust, the beneficiary is considered a “nondesignated beneficiary.” An “eligible designated beneficiary” is defined by statute, and generally includes the surviving spouse, the participant’s child who has not reached the age of majority (at the time of the participant’s death), a disabled or chronically ill beneficiary, or a beneficiary who is not more than 10 years younger than the participant.

The proposed regulations provide important clarifications such as defining the age of majority for MRD purposes as 21, and also defining chronically ill and disabled individuals for MRD purposes. Beneficiaries who want to be considered disabled or chronically ill must satisfy significant documentation requirements, and must provide the plan the documentation no later than October 31 of the year after the death of the participant.

Generally in situations of multiple beneficiaries, much like the current regulations, all beneficiaries are treated in the least advantageous manner, although there are a few exceptions to this approach with respect to beneficiaries who are minor children, disabled, or chronically ill. This treatment highlights

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the importance of providing for separate accounting of beneficiary interests to maximize the tax deferral opportunities.

B. New MRD Payment Timing

When a participant dies before their RBD, the timing of the MRD payments depends on the beneficiary classification:

- **Eligible Designated Beneficiary** – The beneficiary can elect to receive payments (a) beginning in the year after the participant’s death over the beneficiary’s lifetime, or (b) receive the entire amount by the end of the calendar year including the 10th anniversary of the participant’s death.
- **Designated Beneficiary** – The beneficiary must receive the entire amount by the end of the calendar year including the 10th anniversary of the participant’s death.
- **Nondesignated Beneficiary** – The beneficiary must receive the entire amount by the end of the calendar year including the 5th anniversary of the participant’s death.

When a participant dies after their RBD, the timing of the MRD payments once again depends on the beneficiary classification – and becomes more complicated because of the overlay of the “at least as rapidly” rule. So, the MRDs must continue to be paid based on the longer of the participant’s life expectancy or the designated beneficiary’s life expectancy. Most eligible designated beneficiaries may continue to receive the MRDs based on the applicable life expectancy, however, in some cases the entire benefit of the participant must be paid out as provided below:

- If an eligible designated beneficiary dies, then the beneficiary of the eligible designated beneficiary must receive all remaining amounts by end of the calendar year including the 10th anniversary of the eligible designated beneficiary’s death.
- If the eligible designated beneficiary is a minor child, the entire amount of the participant’s benefit must be paid out by the 10th calendar year following the year the child reaches age 21.
- If the eligible designated beneficiary was older than the participant, the entire amount of the participant’s benefit must be paid out by the calendar year when the beneficiary’s remaining life expectancy is less than or equal to one.

Importantly, plan sponsors will need to update their plan documents to provide the complex applicable MRD rules. The plan documents can provide eligible designated beneficiaries the ability to elect between the 10-year and life expectancy distribution rules. If the plan is silent on the MRD distribution rules, the proposed regulations will provide for default rules, which would be the life expectancy rule for eligible designated beneficiaries. Plan sponsors are strongly encouraged to discuss the administrative process with their recordkeepers to make sure their plan document is consistent with administration.

In addition, for DC Plans and IRAs that provide for annuity contracts, the changes noted above for DB plans may also apply. And IRAs and other defined contribution plans that provide for Qualified Longevity Annuity Contracts (“QLAC”) generally must prohibit any commutation benefit, cash

surrender value, or other similar feature. The proposed regulations change the latter restriction so that it only applies after the RBD. This change is intended to facilitate target date funds with QLACs, which fall within the “benefit, rights, and features” relief under Notice 2014-66.

4. Changes Affecting Rollovers

The proposed regulations update the rollover regulations under Code section 402(c) to reflect several amendments to the Code since the regulations were issued in 1995, including some notable changes. For example, the proposed rules clarify rollover treatment for beneficiaries, providing that for participants who die before their RBD, if (1) the 5-year or 10-year payout rule applies, then any payment made prior the 5th year or 10th year, as applicable, is eligible for rollover treatment (unless otherwise excluded); and (2) the life expectancy rule applies, then the amount of the MRD payment is not eligible for rollover treatment. For participants who die on or after their RBD, the amount calculated as the MRD payment is not eligible for rollover treatment.

The regulations also address when rollovers to an IRA may come under the life expectancy rule, as well as providing a special catch-up rule for missed MRD payments to a spouse that will impact the rollover eligibility of distributed amounts. For payments to participants, the proposed regulations clarify that, generally, amounts paid before the year the participant attains age 72 (for participants who reach age 70½ after 2019), should be treated as eligible rollover amounts, if they otherwise meet the requirements.

The listing of amounts not eligible for rollover is also updated to provide that deemed distributions with respect to “collectibles” pursuant to Code section 408(m) are not eligible for rollover treatment. In addition, the proposed regulations reflect the rules under the Code for property rollovers, providing that, while generally limited to the property distributed, the proceeds of a sale of such property (up to the fair market value of the property) may also be rolled over. The Treasury and IRS specifically request comments regarding additional issues relating to the treatment of proceeds.

We also note that the proposed regulations follow Notice 2007-7, Q&A-15, that non-spousal distributees are not subject to 20% withholding, though that does not take into account the changes from Section 108(f) of The Worker, Retiree, and Employer Recovery Act of 2008 (WRERA), so we anticipate this disconnect will be corrected in the final regulations.

5. Changes Affecting 403(b) and 457(b) Plans

The proposed Code section 403(b) and 457(b) regulations continue to generally conform to the defined contribution plan rules (as modified). Notably, however, the IRS asks for comments on making TDA requirements more in line with qualified plan rules – continuing the IRS’ effort to increasingly harmonize 403(b) and 401(a) plans. Among other things, this change would require that each 403(b) contract distribute its MRD payment (like a qualified plan) – rather than allowing a choice between multiple 403(b) plans to satisfy an aggregate MRD requirement.

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6. Effective Dates

The proposed regulations are intended to become effective for distributions for calendar years beginning on and after January 1, 2022. For 2021 distributions, plan sponsors must apply the existing regulations, but taking into account reasonable, good faith interpretations of the SECURE Act.

7. Plan Amendments

These regulations do not extend the deadline for plan amendments to reflect these changes, which are currently due at the end of the 2022 plan year. Nor do they provide for model language to be used in drafting plan amendments, which the Service has historically provided to plan sponsors and IRA providers.

8. Next Steps

Plan sponsors should review the new rules with their recordkeeper and/or third party administrator and see what, if any, changes are necessary for 2022 to comply with these proposed regulations, and consider next steps such as timing for updating MRD communications, distribution packages, plan document amendments, summary plan descriptions (or summary of material modifications), rollover procedures, etc. With 275 pages of proposed regulations, there is an awful lot to wade through – and it is hard to predict the extent of the changes that might come with final regulations, and the timing of those regulations. All of this is a tight timeframe for provisions that, once finalized, will impact 2022 MRD payments.

Comments on the proposed rule should be submitted by May 25 (with a public hearing scheduled for June 15). We are preparing a comment letter on these regulations for a group of clients. If you would like to join the comment group or otherwise have comments or concerns, please contact us.

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