Legislative and regulatory bulletin

IRS proposes amendments to the RMD rules

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New guidance on the SECURE Act's 10-year beneficiary rule

On February 24, 2022, the Internal Revenue Service (IRS) published proposed amendments to the rules on required minimum distributions (RMDs), addressing changes made by the Setting Every Community Up for Retirement Enhancement (SECURE) Act.[1] The IRS's proposed rules are complicated and lengthy—running to 64 pages in the *Federal Register*—and individuals and their advisors will need time to fully digest them. While the proposed rules shed light on many important areas, this article will focus on the parts that address the SECURE Act's changes to required distributions to beneficiaries.

These amendments are proposed to take effect for determining RMDs beginning in 2022. For RMDs due in 2021, the IRS says taxpayers should apply the existing regulations but "taking into account a reasonable, good faith interpretation" of the SECURE Act.

SECURE Act RMD changes

Among its many amendments to retirement plan laws, the SECURE Act made two significant changes affecting RMDs from employer plans and IRAs:

The Act delayed the required beginning date for distributions. It raised the age at which distributions are required to start from 70½ to 72 for participants or traditional IRA holders born on or after July 1, 1949. Specifically, the required beginning date is April 1 of the year following the later of the year the individual reaches age 72 or retires from employment with the plan sponsor.[2]

The required beginning date is important for at least two reasons. First, it is the date by which the plan participant or IRA holder must commence RMDs or face a stiff 50% penalty. Second, it is important for the beneficiaries of deceased individuals because the payout options available to them differ depending on whether the decedent dies before or after the required beginning date.

[1] Federal Register 87, no. 37: 10504–10567.
[2] The required beginning date for plan participants who own more than 5% of their employers is April 1 of the year following the year they reach age 72, even if they still work for the employer.

The Act eliminated many beneficiaries' ability to stretch payments. Because of changes made by the SECURE Act, the general requirement is that the beneficiary must deplete the decedent's account by the end of the tenth year following the year of the decedent's death. This change applies with respect to defined contribution plan participants or IRA owners who die after 2019.

An "eligible designated beneficiary" can still stretch. However, eligible designated beneficiaries (EDBs) are not bound by this 10-year payout rule and can generally stretch the payouts over their life expectancies. An EDB is one of the following:

- The spouse of the decedent
- A minor child of the decedent
- A disabled or chronically ill individual
- An individual who is not more than 10 years younger than the decedent

Proposed RMD rules provide details about EDBs

The age of majority is 21. States have different ages of majority, but for the purposes of the RMD rules, a child of the decedent who has not reached age 21 is an EDB. However, once children reach 21, they no longer are EDBs and will be required to empty the accounts by the end of the tenth year following their 21st birthdays.

Documentation is required for disabled or chronically ill EDBs. To be considered an EDB, a disabled or chronically ill beneficiary must provide certain documentation to the plan administrator (or trustee or custodian for IRAs) by October 31 of the year following the year the participant or IRA owner died. The rules contain definitions of "disabled" and "chronically ill." Beneficiaries who fail to provide documentation by that date will not be considered EDBs and therefore will be subject to the 10-year rule.

The IRS interpretation of the 10-year payout rule has left some scratching their heads

As noted above, the SECURE Act requires distributions to non-EDBs to be made within 10 years after the death of the participant or IRA owner. But according to the IRS's proposed rules, the timing of those payments would differ depending on the decedent's age at death:

Death before the required beginning date. If the participant or IRA owner died before the required beginning date, the non-EDB could withdraw any amount from the decedent's account each year as long as the entire account was distributed by the end of the tenth year following the year of death. For example, the beneficiary could take occasional withdrawals over the 10-year period or wait and take a total withdrawal in the tenth year.

Death on or after the required beginning date. Some were surprised by the provision in the proposed rules that would apply if the participant or IRA owner died on or after the required beginning date. Many interpreted the SECURE Act as saying that the non-EDB could either take occasional withdrawals over the 10-year period or simply wait and take a complete withdrawal from the decedent's account at the end of that period.

But the IRS doesn't see it that way. Instead, the proposed rules would require non-EDBs to take at least a minimum annual withdrawal over the 10-year period, based on their life expectancies, and withdraw any remaining balance by the end of the tenth year.

> Suppose a participant in a 401(k) plan died in 2020 at the age of 75 and her 40-year-old son is her beneficiary. According to the proposed rules, her son should have taken a distribution in 2021 based on his life expectancy and continue to take life expectancy distributions each year thereafter, with a complete distribution of any remaining balance in the account in 2030 (the tenth year following the year of his mother's death).

> But what if the son took no distribution in 2021 because he and his advisors interpreted the SECURE Act's 10-year payout rule as permitting him to delay payments and take a lump sum in 2030? Would he be subject to the 50% penalty for failing to take a required distribution? Or would the IRS deem this to be "a reasonable, good faith interpretation" of the SECURE Act? Would he be required to take a larger distribution in 2022 to make up for the fact that he didn't take one in 2021? These are some of the questions that many groups and individuals will likely ask in their comments to the IRS.

Comments on the proposal are due by May 25. Given that the IRS proposes that the changes be effective for distributions required in 2022, advisors may want to speak with certain clients, especially those who may be affected by the IRS's interpretation of the 10-year rule.

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