Bloomberg Tax

Tax Management
Compensation Planning Journal™

Treasury Releases New Proposed Required Minimum Distribution Regulations

By Avi Bernstein[*]
Epstein Becker & Green
New York, NY

BACKGROUND

The I.R.C. contains rules governing various arrangements that offer the opportunity to save for retirement on a tax-deferred basis. These arrangements include qualified plans described in §401(a),[1] individual retirement arrangements under §408, tax deferred annuities under §403(b), and eligible deferred compensation plans under §457(b). But the deferrals aren't meant to be for an indefinite period. At some point, the money has to come out of the retirement plans and become subject to income tax. The required minimum distribution (RMD) rules under §401(a)(9) govern when distributions from a retirement plan must begin and end.

From 1984 through 2020, key elements of §401(a)(9) were largely unchanged. Retirement plan participants were generally required to start receiving annual RMDs no later than the April 1 following the later attainment of age 70½or termination from employment with the plan sponsor. Five percent or more owners of the plan sponsor were required to commence distributions as of the April 1 following the attainment of age 70½ regardless of whether they have terminated employment with the plan sponsor. The date benefits are required to commence is known as the required beginning date (RBD). If a participant worked for the plan sponsor beyond his RBD, the plan is required to actuarially adjust the participant's benefits to reflect the shorter payout period.

Plan distributions were (and still are) generally required to be completed by the end of the lives of the participant and the designated beneficiary (or the life expectancy of the participant and the designated beneficiary). If the participant dies prior to receiving a complete distribution of a retirement plan account balance, the distribution are currently as follows:[2]

(1) If the participant had started taking required minimum distributions, the distributions need to continue at least as rapidly as the method being used by the participant while alive.[3]

(2) If the participant died prior to commencing RMDs, the applicable distribution rule depended upon the designated beneficiary.

(A) If the beneficiary is the surviving spouse, the spouse could treat the account as if were his/her own, and delay commencement of benefits until the spouse reaches his/her RBD.[4]

(B) For any other beneficiary, the choices were either the:

(i) The life expectancy rule, where the benefits had to commence no later than one year after the death of the participant but could be extended over the life or life expectancy of the beneficiary;[5] or

(ii) The five-year rule, where annual distributions were not required, but the entirety of

[*] Avi Bernstein brings more than 25 years of experience to bear when working with public and private companies and nonprofit organizations on their ERISA and non ERISA employee benefits and executive compensation issues.

This article may be cited as Avi Bernstein, *Treasury Releases New Proposed Required Minimum Distribution Regulations,* 50 Tax Mgmt. Comp. Plan J. No. 4 (Apr. 1, 2022).

[1] All section references herein are to the Internal Revenue Code of 1986, as amended (the Code), or the Treasury regulations promulgated thereunder, unless otherwise indicated.

[2] *See* §401(a)(9)(B).

[3] §401(a)(9)(B)(i)(I)–§401(a)(9)(B)(i)(II).

[4] §401(a)(9)(B)(iv).

[5] §401(a)(9)(B)(iii)(I)–§401(a)(9)(B)(iii)(III).

the account had to be withdrawn by the end of five years following the participant's date of death.[6]

THE SECURE ACT

In 2019, Congress passed the Setting Every Community Up for Retirement Act (the "SECURE Act"),[7] whose provisions were generally effective for calendar years beginning after December 31, 2019. The SECURE Act changed the age portion of the RBD from age 70½ to 72.[8] It did not, however, change the starting date for the actuarial adjustment for delayed commencement. Accordingly, people who work beyond age 70½ must still get actuarial adjustments even if they are not required to commence distributions until age 72.[9]

The SECURE Act also changed the distribution rules for beneficiaries by limiting the life expectancy rule to "eligible designated beneficiaries," and creating a 10-year rule for "designated beneficiaries." The 10-year rule applies even if the participant had already begun receiving required minimum distributions prior to his death. Under §401(a)(9)(E)(i), a "designated beneficiary" is an individual who designated as a beneficiary by the participant. In other words, an entity (trust, estate, charity) cannot be a designated beneficiary.

Section 401(a)(9)(E)(ii) defines an "eligible designated beneficiary" as a designated beneficiary who as of the date of the participant's death, is (1) the surviving spouse of the participant; (2) a minor child of the participant; (3) disabled; (4) chronically ill; or (5) an individual not described elsewhere in §401(a)(9)(E)(ii) who is not more than 10 years younger than the employee.

After revision by the SECURE Act:

(1) A beneficiary who is not a designated beneficiary (i.e., is an entity rather than an individual) is subject to the five-year rule;[10]

(2) A beneficiary who is a designated beneficiary but not an "eligible designated beneficiary" is subject to the 10-year rule;[11] and

(3) A beneficiary who is an eligible designated beneficiary has the choice of the life expectancy rule or the 10-year rule.

[6] §401(a)(9)(B)(ii).

[7] Pub. L. No. 116-94.

[8] §401(a)(9)(C)(i)(I).

[9] §401(a)(9)(C)(iii).

[10] §401(a)(9)(H)(i).

[11] *See* §401(a)(9)(B)(ii).

THE NEW PROPOSED REGULATIONS

On February 24, 2022, the Treasury issued proposed regulations[12] under §401(a)(9). The new proposed regulations run 275 pages and largely repeat existing guidance with modifications as required to reflect the provisions of the SECURE Act.

The proposed regulations contain the following notable items:

- The proposed regulations would not correct the disparity between the start of the actuarial adjust requirement for participants working beyond the old RBD (age 70½) even though the new RBD is age 72. Accordingly, the inconsistency between when actuarial adjustments must be made and when distributions must commence continues.
- The proposed regulations go into extensive detail in addressing key terms within the definition of "eligible dependent beneficiary," including "disability," "chronically ill," and "minor."[13]
- Among the more complicated aspects of RMDs is how to handle multiple beneficiaries. The complications are compounded when one beneficiary is considered an eligible dependent beneficiary and another is not. The regulations offer detailed guidance for such situations.[14]
- Another complicated scenario addressed by the proposed regulations is when the beneficiary is a trust, and when the trust can be looked through and the trust beneficiaries treated as beneficiaries of the participant.
- The proposed regulations would prohibit plan sponsors from creating their own RBD of age 70½ (or any other age).[15] Plan sponsors are not given the opportunity to opt back to the pre-SECURE Act rules.
- The proposed regulations take the position that non-eligible designated beneficiaries subject to the 10-year rule are required to take annual RMDs during the 10-year period.[16] In other words, a non-spouse adult beneficiary would

[12] Prop. Reg. §1.401(a)(9)-1 *et seq.,* REG-105954-20, Required Minimum Distributions, RIN 1545-BP 82,87 Fed. Reg. 10,504 (Feb. 24, 2022) (comments on the proposed rules are due by May 25, 2022).

[13] *See generally* Prop. Reg. §1.401(a)(9)-4. *See also* 87 Fed. Reg. 10,504, 10,509.

[14] *See generally* Prop. Reg. §1.401(a)(9)-4(e)(2), §1.401(a)(9)-5(f). *See also* 87 Fed. Reg. 10,524, 10,529, 10,536.

[15] *See generally* Prop. Reg. §1.401(a)(9)-5.

[16] 87 Fed. Reg. 10,514.

ISSN 0747-8607

have to take an RMD amount each year based on his life expectancy AND take out the entirety of the benefit within 10 years of the participant's death. This position, which is an exercise in statutory interpretation, is inconsistent with five-year rule, where no such annual distributions were required. Further confusing the picture is that in March 2021, the IRS issued a revised Publication 590-B, *Distributions from IRAs,* suggesting that annual RMDs must be paid in years one through nine and the remaining IRA funds to be paid out in year 10. However, the IRS revised Publication 590-B in May 2021 to clarify that annual RMDs are NOT required under the 10-year rule. The proposed regulations are in effect a reversal of the reversal. Commenters will almost certainly raise this issue to the IRS, and there could be yet another reversal when these regulations are finalized.

PLAN AMENDMENTS

Barring extension, plans will have to be amended to reflect the provisions of the SECURE Act by the end of 2022. As the IRS has issued model §401(a)(9) language in the past, it is not unreasonable to expect the distribution of model language or an extension of the deadline before the end of the year.

ISSN 0747-8607