

IRS Proposes Comprehensive Overhaul of Required Minimum Distribution Rules, Incorporating SECURE Act

On February 24, 2022, the Internal Revenue Service (IRS) issued comprehensive proposed regulations (the Proposed Regulations) under Section 401(a)(9) of the Internal Revenue Code (the Code) which describe the required minimum distribution rules. Among other things, the Proposed Regulations cover changes to the minimum distribution rules that were made in 2019 by the SECURE Act.

Code Section 401(a)(9) is intended to prevent employees from indefinitely delaying distributions under a tax-qualified retirement plan, individual retirement account (IRA) and certain other tax-favored accounts by requiring employees to begin receiving minimum distributions from the plan or account by a certain date. For purposes of simplicity, in this article (and in the Proposed Regulations) the term “employee” is used to denote a qualified retirement plan participant, an IRA owner or other tax-favored account participant or owner.

In addition to explaining changes to the required minimum distribution rules made by the SECURE Act, the Proposed Regulations address issues raised in existing IRS positions and rulings. When finalized, the Proposed Regulations will replace the current minimum distribution regulations which date back to the early 2000s. This article briefly summarizes the changes to the minimum distribution rules made by the SECURE Act and provides a brief overview of some of the more significant features of the Proposed Regulations. This article generally focuses on the application of the Proposed Regulations to defined contribution plans.

While the SECURE Act amendments to the minimum distribution rules are currently in effect, the Proposed Regulations are not binding until they are published in final form. Some aspects of the Proposed Regulations are controversial and we would expect to see some changes when final regulations are published.

D&M’s Perspective: As discussed in more detail below, the SECURE Act requires certain beneficiaries of a deceased employee to receive the decedent’s benefit over a 10-year period following the decedent’s death. If the decedent dies on or after the “required beginning date” (see below), one potentially controversial and confusing provision of the Proposed Regulations would require the beneficiary to take annual payments during years 1 – 9, with the remaining balance paid in year 10. By contrast, many practitioners have interpreted the SECURE Act to permit the benefit to be paid at any time during the 10-year period, including payment of the entire balance in year 10.

Typically, final regulations do incorporate some changes from proposed regulations. In light of this, the preamble to the Proposed Regulations provides that employers should in the meantime take into account a reasonable, good faith interpretation of the SECURE Act amendments to the Code in applying the minimum distribution rules. The preamble also states that compliance with the Proposed Regulations will automatically be treated as satisfying that standard.

The Proposed Regulations would apply for purposes of determining minimum distributions for calendar years beginning on or after January 1, 2022.

SECURE Act Changes to Section 401(a)(9)

The SECURE Act made two major changes to the minimum distribution rules:

- delays the age for beginning minimum distributions from 70½ to 72, and
- eliminates the “stretch” payout period for certain non-spouse beneficiaries.

An employee is generally required to begin receiving “required minimum distributions” by his or her required beginning date. Prior to the SECURE Act, an employee’s required beginning date was April 1 of the calendar year following the calendar year in which the employee attained age 70½. The SECURE Act delays that age to 72. The new SECURE Act age applies to distributions required to be made after December 31, 2019 for individuals who attain age 70½ after that date.

Notwithstanding this age change, an employee who participates in a qualified plan – but not an IRA - and who does not own (and is not deemed to own) more than 5% of the employer, can delay taking minimum distributions beyond age 72 until he or she retires.

The SECURE Act also generally eliminated the so-called “stretch” payout method from a plan for non-spouse beneficiaries. Prior to the SECURE Act, a non-spouse designated beneficiary could take distributions over his or her life expectancy. Under the SECURE Act, non-spouse beneficiaries are generally required to take their benefits into income by the end of the tenth calendar year following the year of the employee’s death. The SECURE Act preserved the life expectancy method for a non-spouse designated beneficiary who: (a) is disabled, (b) has not attained the age of majority, (c) is a chronically ill individual or (d) is less than ten years younger than the employee. The SECURE Act rules curtailing stretch payments apply to distributions with respect to employees who die after December 31, 2019.

Proposed Regulations Highlights

- a. Age for Required Beginning Date. Consistent with the most common interpretation of the SECURE Act change to the required beginning date age, the Proposed Regulations confirm that if the employee’s birthdate is prior to July 1, 1949, the old age 70½ rule applies, and if the employee’s birthdate is on or after July 1, 1949, the new age 72 rule applies.
- b. Eligible Designated Beneficiary
 1. Age of Majority. The Proposed Regulations generally provide that a child of an employee reaches the age of majority on the child’s 21st birthday.
 2. Disability. Under the Proposed Regulations, the standard applied in determining disability for minimum distribution purposes is generally based on whether an individual is unable to engage in substantial gainful activity. However, a different disability standard is applied for a beneficiary who is under age 18. In addition, under a safe harbor, an individual who has been determined to be disabled by the Social Security Administration will in all events be treated as disabled for minimum distribution purposes. Significantly, the applicable disability standard is applied exclusively as of the date of the employee’s death. In an example in the Proposed Regulations, an employee’s

child is 10 years old and not disabled at the time of the employee's death, but the child becomes disabled at age 15. The example concludes that the child will cease to be an eligible designated beneficiary on the child's 21st birthday (the age of majority without regard to the child's disability).

3. Documentation of Disabled or Chronically Ill Status. The Proposed Regulations provide that documentation of a disabled or chronically ill beneficiary must be provided to the plan administrator no later than October 31 of the calendar year following the calendar year of the employee's death. For a beneficiary who is chronically ill, the documentation must include a certification by a licensed health care practitioner that the beneficiary is chronically ill.
4. Multiple Designated Beneficiaries. Under the Proposed Regulations, if an employee has more than one designated beneficiary and one of them is not an eligible designated beneficiary, then the employee generally is treated as not having an eligible designated beneficiary. Under an exception, a deceased employee's minor child is treated as an eligible designated beneficiary even if the employee has other beneficiaries who are not eligible designated beneficiaries. Another exception provides for the minimum distribution rules to be applied separately to the separate interest of each of the employee's beneficiaries if separate accounts are maintained for each beneficiary in accordance with the Proposed Regulations.
5. Permitted Delay by Surviving Spouse. A surviving spouse who is the employee's sole beneficiary is permitted to wait to begin distributions until the year in which the employee would have attained age 72 (or age 70½ as applicable).
6. Beneficiary of Surviving Spouse. If a surviving spouse is waiting to begin distributions until the year in which the employee would have attained age 72 (or age 70½), as described in the preceding paragraph, and the surviving spouse dies before the beginning of that year, then the determination of whether the surviving spouse's designated beneficiary is an eligible designated beneficiary is made by substituting the surviving spouse for the employee (including for purposes of establishing the date as of which that determination is made). An example in the Proposed Regulations states that a child of the surviving spouse is an eligible designated beneficiary if the child has not yet reached the age of majority as of the date of the surviving spouse's death.

c. Trust as Beneficiary

The Proposed Regulations retain the "see-through trust" concept in the existing regulations under which certain beneficiaries of a trust are treated as beneficiaries of the employee under the plan if the trust meets the requirements to be a see-through trust. For example, if a see-through trust is named as the beneficiary of the employee's benefit, and the see-through trust has a single trust beneficiary, then the beneficiary of the trust, and not the trust itself, is treated as the employee's beneficiary for purposes of determining minimum distributions after the employee's death.

The Proposed Regulations generally do not change the requirements that must be satisfied for a trust to qualify as a see-through trust, but the Proposed Regulations do provide additional details and examples of see-through trusts, including situations involving multi-beneficiary trusts.

d. New Minimum Distribution Payment Timing

The first step in determining the timing of minimum distributions is to ascertain whether the employee died (i) before his or her required beginning date or (ii) on or after the required beginning date. The next step is to determine how the beneficiary is categorized under the Proposed Regulations. This analysis is briefly summarized in (1) and (2) below.

1. Employee Dies Before Required Beginning Date

If Beneficiary Is:	Payment Timing Is:
Eligible designated beneficiary	Plan can permit beneficiary to elect to receive: <ul style="list-style-type: none"> • payments over beneficiary's lifetime beginning by end of calendar year following calendar year of employee's death, or • entire amount by end of calendar year that includes 10th anniversary of date of employee's death
Designated beneficiary but not eligible designated beneficiary	Entire amount paid by end of calendar year that includes 10 th anniversary of the date of employee's death
Not designated beneficiary (e.g., the employee's estate)	Entire amount paid by end of calendar year that includes 5 th anniversary of date of employee's death

2. Employee Dies On or After Required Beginning Date

If Beneficiary Is:	Payment Timing Is:	
Eligible designated beneficiary	Payments generally continue over longer of employee's remaining life expectancy or beneficiary's remaining life expectancy	<i>However, entire amount must be paid in the case of:</i> <ul style="list-style-type: none"> • Eligible designated beneficiary's death – by end of 10th calendar year following calendar year of beneficiary's death • Minor child attains age of majority – by end of 10th calendar year following calendar year of attainment of age of majority • Eligible designated beneficiary who was older than employee – by end of calendar year in which beneficiary's remaining life expectancy is less than or equal to one
Designated beneficiary but not eligible designated beneficiary	Entire amount must be paid by end of 10 th calendar year following calendar year of employee's death (<i>see also paragraph following this table</i>)	
Not designated beneficiary	Payments generally continue for employee's remaining life expectancy	

In applying the 10-year payment rule in the case of an employee who dies on or after the required beginning date, the Proposed Regulations would require annual payments based on the applicable life expectancy during years 1 – 9, with the remaining balance of the entire amount paid in year 10. This interpretation is at odds with how the language of the SECURE Act has been interpreted by many practitioners, which is to permit the balance of the entire amount to be paid at any time within the 10-year period, including payment of the entire amount in year 10. By contrast, if the employee dies before the required beginning date, the Proposed Regulations would allow the beneficiary to withdraw the amount at any time during the ten year period, including the entire amount in year 10.

D&M's Perspective: We would not be surprised if this bifurcated treatment of the 10-year rule, depending on whether death occurs before, or on or after, the required beginning date, was eliminated in the final regulations.

If you have any questions concerning the Proposed Regulations and how they may apply to your retirement plan or particular situation, please contact Andrew Roth, (914) 220-8033, ARoth@dmlawyers.com.