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Proposed IRS Regulations Clarify SECURE Act Changes to RMD Rules for Beneficiaries

by Samuel J. Baldwin on April 28, 2022

When the Setting Every Community Up for Retirement Security Act of 2019 (SECURE Act) took effect on January 1, 2020, it changed the rules for retirement plan required minimum distributions (RMDs) to participants and beneficiaries. Earlier this year, the IRS released proposed regulations implementing those changes. The regulations are expansive and, if finalized, would mark a significant change to how RMDs must be administered.

The following overview focuses on one key set of changes: how RMDs are distributed to beneficiaries under defined contribution plans, such as 401(k) plans, profit sharing plans, and 403(b) plans. These changes include several new requirements that are often described as "eliminating stretch RMDs."

Distributions to Beneficiaries under Defined Contribution Plans

The RMD rules require distributions following a participant's death to meet a number of requirements that affect the timing and amount of distributions. The SECURE Act changed these rules for defined contributions plans, as part of an effort to limit beneficiaries' ability to stretch distributions – and the associated taxes – over extended periods of time. The timing rules for RMDs paid to beneficiaries under defined benefit plans remain generally unchanged.

For most plan sponsors, these changes to the timing rules for distributions to beneficiaries from a defined contribution plan may require the most significant changes to plan administration.

To understand how the new rules for defined contribution plans affect RMD administration, it is important to understand that under the SECURE Act and the proposed regulations, there are now three categories of beneficiaries. When a participant dies *before reaching the participant's required beginning date*, each category of beneficiary has a different deadline for plan distributions.

(1) *Eligible designated beneficiaries* – an individual who is the participant's designated beneficiary and is the participant's surviving spouse or minor child, or is disabled, chronically ill, or no more than 10 years younger than the participant.

- Must either:
    - Receive distributions beginning in the year after the participant's death and continuing for the life or life expectancy of the beneficiary, or

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    - Receive distribution of the participant's entire remaining vested account balance by the end of the calendar year that includes the tenth anniversary of the participant's death (for a minor child, the deadline is generally the end of the calendar year that contains the tenth anniversary of the child's 21st birthday).

  - The plan document may specify whether the 10-year rule or the life expectancy rule will apply, or it may specify that eligible designated beneficiaries can choose between the two. If the plan document is silent, the beneficiary does not get an option, and the life expectancy rule applies.

  - If the eligible designated beneficiary is the participant's minor child, the child ceases to be an eligible designated beneficiary when the child reaches age 21, and distribution under the life expectancy rule may continue for nine years after the child reaches age 21, with distribution of the entire remaining vested account balance made in the tenth year after the child reaches age 21.

  - If the eligible designated beneficiary is the participant's surviving spouse, the beneficiary may elect to wait to commence RMDs until the year the participant would have attained age 72 (age 70½, if the participant was born before July 1, 1949).

(2) *Designated beneficiaries* – an individual who is the participant's designated beneficiary but is not an eligible designated beneficiary.

  - Distributions must be completed by the end of the year that includes that tenth anniversary of the participant's death.

(3) *Nondesignated beneficiaries* – a beneficiary who is not a designated beneficiary, or that is not an individual, such as a trust[1] or estate.

  - Distributions must be completed by the end of the year that includes that fifth anniversary of the participant's death.

The proposed regulations include several new definitions and other provisions for determining when a beneficiary is an eligible designated beneficiary, including:

[1] Certain trusts may be considered "see-through" trusts and may be treated as designated beneficiaries. The proposed regulations provide rules for determining when a "see-through" trust constitutes a designated beneficiary.

- A definition of "disabled" and rules applicable to the determination of whether a beneficiary is disabled.

- Required documentation to establish whether a beneficiary is disabled or chronically ill, and a deadline for producing this documentation to the plan sponsor (generally October 31 of the year after the death of the participant).

- Rules for determining eligible designated beneficiary status where a participant has multiple designated beneficiaries. Generally, unless the beneficiaries are accounted for separately in accordance with certain requirements, if any beneficiary is not an eligible designated beneficiary, none of the beneficiaries are treated as eligible designated beneficiaries.

If the Participant Dies After Required Beginning Date

If a participant in a defined contribution plan dies after reaching the participant's required beginning date, the participant's designated beneficiary generally must receive RMDs calculated over the longer of the life expectancy of the beneficiary and the life expectancy of the participant, determined as of the year the participant died. Under a special rule applicable only if the surviving spouse is the participant's sole beneficiary, the spouse's life expectancy may be recalculated each year. If the participant does not have a designated beneficiary, RMDs are calculated over the life expectancy of the participant.

In the circumstances described below, however, the participant's entire remaining vested account balance must be distributed within a certain number of years after the participant's death. The preamble to the proposed regulations anticipates this will mean a lump sum distribution of the remaining vested account balance in the final year.

- If the participant's designated beneficiary is *not* an eligible designated beneficiary, the participant's entire remaining vested account balance must be distributed by the end of the calendar year that includes the tenth anniversary of the *participant's* death.

- If the participant's designated beneficiary is an eligible designated beneficiary, the participant's entire remaining vested account balance must be distributed by the end of the calendar year that includes the tenth anniversary of the *eligible beneficiary's* death.

- If the participant's designated beneficiary is the participant's child and is a minor as of the participant's death, the participant's entire remaining vested account balance must be distributed by the end of the tenth calendar year following the year the beneficiary reaches 21 years old.

- If the participant's designated beneficiary is an eligible designated beneficiary, and the eligible designated beneficiary's RMDs are calculated over the life expectancy of the participant, the participant's entire remaining vested account balance must be distributed by the end of the eligible designated beneficiary's life expectancy, as calculated at the time of the participant's death.

Effective Date of Proposed Regulations

If finalized, the proposed regulations would be effective for RMDs for calendar years beginning on or after January 1, 2022.

The proposed regulations state that RMDs for 2021 should be made according to the current regulations, taking into account a reasonable, good faith interpretation of how the regulations are affected by the SECURE Act. According to the preamble, compliance with the proposed regulations satisfies that requirement.

Plan Amendments and Other Updates

Plans that are subject to the RMD rules must be amended, as necessary, to reflect the SECURE Act changes. Generally, these amendments are due by the end of the 2022 plan year (December 31, 2022, for calendar year plans).

Notably, the IRS has not yet provided model plan amendment language for the SECURE Act changes to the RMD rules. It is possible that the IRS will provide model language in the future, but sponsors of individually designed plans should be prepared to work with their advisors to prepare amendments by the deadline without model language.

If they have not already done so, plan sponsors should update SPDs, RMD communications, distribution election packets, and administrative procedures to reflect the SECURE Act changes to the RMD rules.

Please contact a member of our Employee Benefits & Executive Compensation Group for assistance preparing or reviewing retirement plan amendments for the new RMD rules, or if you have any questions about how to implement the rules in practice.

Samuel J. Baldwin
Associate
T (207) 253 4532
email