IRS Releases Proposed Required Minimum Distribution Regulations

After a two-year wait, we have guidance regarding certain changes brought about by the SECURE Act. On February 23, 2022, the IRS released [proposed regulations] that revise the existing required minimum distribution (RMD) regulations and other related regulations.

Proposed Regulations—Background

The SECURE Act—officially known as the Setting Every Community Up for Retirement Enhancement Act of 2019—made significant changes to IRA and retirement plan rules. Among other things, the SECURE Act raised the starting age for RMDs from 70½ to 72, changed the five-year beneficiary payout rule to 10 years (for most beneficiaries), and allowed fewer beneficiaries to take retirement distributions over their lifetimes.

Good Faith Compliance With the Proposed Regulations Provides Relief

The proposed regulations include provisions relating to RMDs, rollovers, and to penalty taxes that apply when RMDs are not taken properly. Although most of the SECURE Act provisions became effective on January 1, 2020, these regulations are proposed to become effective on January 1, 2022. For 2021, the preamble to the proposed regulations states that taxpayers must apply the existing regulations and exercise a "reasonable, good faith interpretation" of the increased RMD age and 10-year rule created by the SECURE Act. Compliance with the proposed regulations will satisfy that requirement.

Defined Contribution Plan and IRA Provisions

The SECURE Act made some fundamental changes to the distribution rules. Because the rules differ depending on whether the account owner died before 2020, or on or after January 1, 2020, we now have to understand two separate sets of rules. For example, if an IRA owner died in 2019, a nonspouse beneficiary could take annual required distributions over that beneficiary's lifetime. But if that same IRA owner died in 2020, the beneficiary may not have that option. As a result of these and other changes, the IRS has rewritten the regulations.

The 10-Year Rule

One of the most important changes contained in the SECURE Act was the elimination of the so-called "stretch" provision for many beneficiaries. As a result, beneficiaries will no longer be able to take life expectancy payments unless they fall into one of these categories. These individuals are called "eligible designated beneficiaries."

- Account owner's spouse
- Individual who is not more than 10 years younger than the account owner
- Disabled or chronically ill individual
- Account owner's minor child (under age 21)
- Beneficiary of account owner who died before January 1, 2020

The 10-year rule changes IRA and retirement plan administration substantially. For example, adult children and grandchildren who are beneficiaries will now be subject to the 10-year rule, which requires distribution of all inherited assets by the end of the 10th year following the original account owner's death. But spouse beneficiaries retain the options of taking annual payments over their life expectancy, or (more commonly) taking the assets as their own. Nonspouse beneficiaries who are not more than 10 years younger than the decedent may continue to exercise the

lifetime payout option; nonspouse beneficiaries more than 10 years younger (unless they meet another exception) are subject to the 10-year rule.

"At Least As Rapidly" Rule

Current rules require beneficiaries to take distributions "at least as rapidly" as the account owner if the account owner dies on or after the required beginning date (RBD). For those beneficiaries that are subject to the 10-year rule, the proposed regulations would require them not only to deplete their account balance by the end of the year that contains the 10th anniversary of the original account owner's death, but they must also take annual distributions for the first nine years, based on the normal single life expectancy calculation.

Different Categories of Beneficiaries

Individuals who do not meet the definition of "eligible designated beneficiary" are simply referred to as "designated beneficiaries" and are normally subject to the 10-year rule (again, for deaths in 2020 or later years). Beneficiaries that are not individuals—such as trusts or estates—are not considered designated beneficiaries. These beneficiaries are subject to the same options as before: they generally default to the five-year rule if the account owner dies before the RBD and to life expectancy payments based on the account owner's age if the account owner dies on or after the RBD.

Separate Accounting Principles Still Apply

The concept of separate accounting for beneficiaries remains intact in the proposed regulations. If separate accounts are created and maintained for multiple beneficiaries by December 31 of the year following the account owner's death, each beneficiary will be treated as the sole beneficiary of that account. Practically, this means that, even if there are different beneficiary categories with different payout options, separate accounting will preserve the available options for each category.

Trusts as Beneficiaries

Naming a trust as the beneficiary of a retirement account can make sense in various contexts, but the rules can be complex. The proposed regulations make one thing clear: "see-through trusts" (or "qualified trusts") are still alive and well. The see-through trust concept will likely remain popular because it allows the underlying beneficiaries of such trusts to be treated as designated beneficiaries—or eligible designated beneficiaries—if the trust meets certain requirements. To qualify as a see-through trust,

- the trust must be valid under state law;
- the trust must be irrevocable, or become irrevocable upon the account owner's death;
- the trust must contain identifiable beneficiaries (even if they are not specifically named); and
- trust documentation must be provided to the account administrator.

Other Notable Provisions

- **"Hypothetical RMDs" not eligible for rollover treatment.** Assume that a 401(k) plan participant dies before the RBD and has a spouse beneficiary who elects the 10-year rule. The spouse beneficiary rolls over the inherited assets to her own IRA before the last year of the 10-year window but in a year that she is at least age 72. The proposed regulations require the beneficiary to calculate a hypothetical RMD—an amount that would have been required to be distributed had the life expectancy rule applied to the spouse beneficiary—and exclude that amount from any rollover contribution.

- **Automatic waiver of 50% penalty tax for switching to the 10-year rule.** Suppose that an account owner dies before the required beginning date and an eligible designated beneficiary fails to take a life expectancy payment. The IRS will automatically waive the penalty tax if 1) the beneficiary did not make an affirmative election to take life expectancy payments (e.g., a plan provision defaulted to that method), and 2) the beneficiary elects the 10-year rule by the end of the ninth calendar year following the account owner's death.
- Automatic waiver of 50% penalty tax for missing year-of-death RMD. The IRS will also waive the penalty tax if a beneficiary fails to take an RMD by the end of the year in which the account owner dies. To get this automatic relief, the beneficiary must remove the year-of-death RMD by the beneficiary's tax filing deadline, including extensions.

Final Regulations May Take Some Time

At this point, a public hearing is slated for June 15, 2022, to address the comments that the IRS has received. After that, it may take several months for the IRS to release final regulations.

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