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IRS proposes updates to RMD rules for SECURE Act and more

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In this article

Proposed IRS regulations would implement two significant changes to the rules for required minimum distributions (RMDs) under Internal Revenue Code (IRC) Section 401(a)(9). The proposal reflects statutory changes made by the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 (Div. O of Pub. L. No. 116–94). Those changes include an increase in the age that triggers RMDs from 70-1/2 to 72 and new limits on life expectancy distributions to defined contribution (DC) plan beneficiaries. Another somewhat controversial revision eliminates the Q&A format of the current 401(a)(9) regulations. The proposal also reflects various other statutory changes, including updates to the regulations on rollover distributions under IRC Section 402(c). IRS is accepting comments on the proposal through May 25.

Age increase for RMDs

The SECURE Act pushed back the date at which a participant must start taking RMDs, known as the required beginning date (RBD), to April 1 after the year the participant turns age 72 or retires, whichever is later (except 5% owners, who can't delay RMDs until after retirement). The change applies to participants in employer-sponsored DC and defined benefit (DB) plans — including all qualified, 403(b) and governmental 457(b) plans — who turn age 70-1/2 after Dec. 31, 2019. For participants who reached 70-1/2 before that date, the triggering age for RMDs remains 70-1/2.

Proposal clarifies statutory language

The proposal makes three clarifications regarding the RBD and actuarial increases:

- The statute says the new RBD applies to participants reaching age 70-1/2 after 2019. The proposal clarifies that the new RBD applies to participants who have birthdays on or after July 1, 1949.

Though the two phrasings are mathematically equivalent, the new language explicitly applies the old rules to participants born before July 1, 1949, who died before reaching age 70-1/2 and their beneficiaries.

- Section 401(a)(9)(C) requires plans to provide actuarial increases to most DB participants retiring after age 70-1/2. As revised by the SECURE Act, however, the statute suggests that participants retiring between ages 70-1/2 and 72 wouldn't receive an actuarial increase. The proposal clarifies that participants retiring after 70-1/2 must get actuarial increases from the April 1 after turning 70-1/2 until their retirement date.
  - Five-percent owners must start RMDs at their RBD and don't get an actuarial increase. This didn't disadvantage them relative to non-5% owners when the RBD and actuarial-increase age were both 70-1/2. However, under the proposal, 5% owners still don't get an actuarial increase even though their RBD has changed to age 72. Effectively, 5% owners will have an extra one- or two-year suspension of benefits (depending on their birthday) from the old to new RBD.
  - The actuarial-increase requirement doesn't apply to governmental or church employees. The proposal clarifies that employees of nonqualified church-controlled organizations are not considered church employees for this purpose and must receive the actuarial increase.

No guidance for plans not adopting age 72

The proposal is silent on plans that want to continue forcing participants to begin payments at 70-1/2. Some plan sponsors would prefer to leave their administrative practices unchanged, especially DB plan sponsors providing generous actuarial increases (which still must start at 70-1/2, regardless of a change in RBD).

When the statutory definition of the RBD last changed in 1996 to delay it until retirement for participants other than 5% owners, IRS regulations let plans continue using age 70-1/2 even for active employees, as long as that RBD applied to 5% owners as well as other participants. The new proposal likewise would allow a plan to uniformly define its RBD as April 1 after the year a participant reaches the applicable RMD-triggering age, regardless of whether the participant has retired or is a 5% owner.

However, the proposal doesn't address plans that don't update their RBD to age 72 for employees reaching 70-1/2 after 2019. Given the lack of guidance, employers retaining 70-1/2 as the triggering age might want to discuss their approach with legal counsel.

Further possible increases to RBD on the horizon

While IRS is still in the throes of implementing the SECURE Act, Congress is already considering additional changes to the RBD. Under the Securing a Strong Retirement Act of 2022 (HR 2954, sometimes referred to as "SECURE 2.0"), which recently passed the House of Representatives with overwhelming support, the RMD triggering age would gradually increase over 10 years to the following:

- Age 73 for participants who reach age 72 after Dec. 31, 2022, and age 73 before Jan. 1, 2030

- Age 74 for participants who reach age 73 after Dec. 31, 2029, and age 74 before Jan. 1, 2033
- Age 75 for participants who reach age 74 after Dec. 31, 2032

Limitation on ‘stretch’ payments to DC plan beneficiaries

Before the SECURE Act, the distribution of a deceased participant’s benefit under both DB and DC plans had to follow one of two rules, depending on whether benefit payments began before the participant’s death. If payments began before death, distributions to the beneficiary had to continue at least as rapidly as the participant had been receiving them. If payments hadn’t begun before death, the benefit had to be distributed within five years of the participant’s date of death, or payments could be stretched over a period not exceeding the designated beneficiary’s life expectancy (“stretch” payments). Stretch payments had to start within a year of the participant’s death, except a surviving spouse could delay commencement until the date the participant would have reached the RBD.

SECURE Act provisions

The SECURE Act restricts the availability of stretch payments under DC plans (but not DB plans) to an “eligible designated beneficiary” (EDB). An EDB is an individual who, on the participant’s date of death, is any of the following:

- The participant’s surviving spouse
- The participant’s minor child (but payments must end 10 years after the child reaches the age of majority)
- A disabled person
- A chronically ill person
- A person not more than 10 years younger than the participant

For all other designated beneficiaries under a DC plan, complete distribution of a deceased participant’s account must be made within 10 years of the participant’s death — regardless of whether the participant was receiving payments before death. Similarly, upon the death of an EDB who is receiving stretch payments, any remaining portion of the benefit must be paid within 10 years of the EDB’s death. The five-year rule remains in effect for beneficiaries who are not designated beneficiaries (eligible or otherwise).

Effective date. The SECURE Act states that this change generally applies to distributions from the accounts of DC plan participants who die after Dec. 31, 2019. However, later dates apply to the following plans:

- For plans subject to a collective bargaining agreement ratified before Dec. 20, 2019 (the enactment date of the SECURE Act), the new rule applies to distributions with respect to participants who die in calendar years beginning after the bargaining agreement expires, but no later than Dec. 31, 2021.

- For governmental plans, the rule applies to distributions with respect to participants who die after Dec. 31, 2021.

If a participant with a designated beneficiary dies before this effective date, and the beneficiary dies after the effective date, the limitation on stretch payments applies to the beneficiary of the participant's designated beneficiary.

Certain existing annuity contracts exempt. The SECURE Act provides that the limitation on stretch payments does not apply to existing commercial annuity contracts if the participant made an irrevocable election about the method and amount of the annuity payments before Dec. 20, 2019.

Proposed rules

The proposal includes a significant amount of detail on the new limitation on stretch payments.

Participant dies before RBD

If a participant with an EDB dies before reaching the RBD, payments can be made under the stretch rule or the 10-year rule, according to plan terms. If the stretch rule applies, payments must start in the year after the participant's death, unless the EDB is the participant's spouse. In that case, the spouse can delay commencement of the benefit until the year the participant would have reached the RBD triggering age. If the participant dies with a designated beneficiary who's not an EDB, the benefit must be distributed within 10 years of the participant's death.

The proposal clarifies that if the 10-year rule applies, complete distribution must be made by the end of the 10th calendar year after the calendar year of the participant's death (i.e., the end of the calendar year containing the 10th anniversary of the participant's death). For example, if a participant dies on Feb. 1, 2023, with a designated beneficiary who is not an EDB, the participant's benefit must be completely distributed by Dec. 31, 2033. The proposal also clarifies that distributions don't have to start before this date (this is consistent with the five-year rule under the current regulations).

Participant dies after RBD

If a participant dies after the RBD, Section 401(a)(9) requires distributions to the participant's beneficiary be made at least as rapidly as the participant had been receiving. This is true for all beneficiaries.

The regulations specify how distributions after the participant's death satisfy the "at least as rapidly" rule. If the participant has an EDB, the stretch rule or 10-year rule can apply. If the participant's designated beneficiary is not an EDB, post-death distributions must end by the earlier of:

- The end of the 10th year after the year of the participant's death
- The end of the participant's or the beneficiary's life expectancy, whichever is longer

Plan can specify which rule applies

Current regulations give DC plans latitude in applying the distribution rules to designated beneficiaries, and the proposal grants similar latitude for EDBs (but not for designated beneficiaries):

- The plan can require payments to EDBs to follow the stretch rule or 10-year rule.
- The plan can let the participant or EDB choose which rule applies, but the plan must specify which rule applies if no election is made.
- If the plan is silent on which rule applies, payments to EDBs must follow the stretch rule.
- The plan needn't apply the same rule to all participants' EDBs.

Five-year rule applies if no designated beneficiary

Under the statute, the 10-year rule applies to *designated* beneficiaries who aren't EDBs. The proposal confirms that if a participant doesn't designate a beneficiary, the five-year rule continues to apply. Under both the current and proposed regulations, only individuals can be designated beneficiaries. If a participant chooses a beneficiary that's not a person (e.g., the participant's estate), the participant will be treated as having no designated beneficiary (exceptions apply to certain see-through trusts — see Trust beneficiary rules below).

Clarification of EDB categories

The proposal provides significant detail on how to determine if a designated beneficiary is an EDB. The designation is made as of the participant's date of death, so a designated beneficiary cannot become an EDB by later satisfying one of the conditions (e.g., becoming disabled two years after the participant's death).

Minor children and age of majority. If a participant's child is the designated beneficiary and is still a minor on the participant's date of death, the child is an EDB under the statute. This allows the child to receive stretch payments, but only until the child attains the age of majority. Any remaining portion of the benefit must be distributed within 10 years after that date.

The definition of "age of majority" isn't consistent across the country, and the statute doesn't set an age for this purpose. To avoid confusion and complexity for participants and to simplify plan administration, the proposal would set the age of majority at 21. Plans could not choose to use a different definition.

Disabled. Section 401(a)(9)(E)(ii)(III) provides that "disabled" has the same meaning for 401(a)(9) purposes that applies under IRC Section 72 when determining if payments attributable to the recipient's becoming disabled are exempt from the 10% penalty tax on distributions before age 59-1/2. Under Section 72, "disabled" means unable to engage in any substantial gainful activity due to a physical or mental impairment that's expected to result in death or have a long-continuing and indefinite duration.

IRS believes this standard may be difficult to apply to beneficiaries under age 18. Accordingly, the proposal includes a comparable standard for such beneficiaries without reference to the beneficiary's ability to engage in gainful employment.

In addition, the proposal has a safe harbor rule under which a beneficiary will be deemed disabled for Section 401(a)(9) purposes if, as of the participant's date of death, the beneficiary has already received a disability determination from the Social Security Administration.

Chronically ill. The proposal uses essentially the same as the definition of "chronically ill" as the SECURE Act. A designated beneficiary is considered chronically ill if any of the following apply:

- A loss of functional capacity prevents the beneficiary from performing at least two activities of daily living without substantial assistance for an indefinite period that is reasonably expected to be lengthy.
- A level of disability results in a loss of functional capacity similar to what's described in the preceding bullet.
- A cognitive impairment requires substantial supervision to protect against threats to the beneficiary's health and safety.

Documentation required. The proposal would require EDBs to provide documentation of any disability or chronic illness to the plan administrator by Oct. 31 of the calendar year after the calendar year of the participant's death. The proposal does not specify any particular documentation requirements for disabled EDBs. However, for chronically ill EDBs, the beneficiary must provide a licensed healthcare provider's certification that the beneficiary is chronically ill under one of the definitions listed above. The certification must attest to the expected indefinite and lengthy nature of the loss of functional capacity under the first bullet above, if applicable.

If a designated beneficiary qualifies as an EDB under multiple categories that include the disabled or chronically ill, documentation is still required. For example, if a participant's minor child is the designated beneficiary and is also disabled, documentation of the child's disability must be timely provided to the plan administrator for the child to remain an EDB after reaching the age of majority.

Surviving spouse dies before commencing benefit. As noted above, Section 401(a)(9) allows the surviving spouse of a participant who dies before the RBD to delay commencement of the benefit until the year the participant would have reached the RBD triggering age. Under the proposal, if the spouse decides to delay commencement but dies before payments begin, whether the spouse's designated beneficiary is an EDB is determined as of the spouse's date of death.

Multiple beneficiaries. Under the proposal, if a participant has multiple designated beneficiaries and one of them isn't an EDB, then none of the beneficiaries is considered an EDB for Section 401(a)(9) purposes. However, the proposal includes two exceptions to this rule:

- If any of the designated beneficiaries are minor children of the participant, the participant is treated as having an EDB, and payments can continue until Dec. 31 of the year in which the oldest minor child turns age 31.

- If the designated beneficiary is a “type II” applicable multibeneficiary trust (see below), then the trust beneficiaries who are either disabled or chronically ill are treated as EDBs.

In addition, the proposal addresses whether the new limitation on stretch payments applies at all if a participant dies with multiple beneficiaries. If such a participant dies before Jan. 1, 2020, the limitation applies if the oldest beneficiary dies on or after Jan. 1, 2020.

Trust beneficiary rules

Under existing regulations, only a person can be designated as a participant’s beneficiary. But the regulations make an exception for certain “see-through” trusts that satisfy the requirements of Treasury Regulation Section 1.401(a)(9)-4, Q&A-5. The proposal retains this concept, but includes much more detail on how to determine if a trust’s beneficiaries are treated as beneficiaries of a participant’s interest in a plan. IRS and the Treasury Department provided this additional detail to minimize the need for taxpayers to request private letter rulings on the status of trust beneficiaries. (This article does not cover the full scope of this additional detail.)

Applicable multibeneficiary trusts. The SECURE Act added to Section 401(a)(9)(H) the concept of “applicable multi-beneficiary trusts” under which certain beneficiaries can be EDBs. The proposal identifies these trusts as “type I” and “type II” applicable multibeneficiary trusts.

- Under a type I trust, the terms provide that it will be divided immediately upon the employee’s death into separate trusts for each beneficiary. In this case, the determination of whether a trust beneficiary is an EDB can be made separately for each beneficiary.
- Under a type II trust, one or more disabled or chronically ill EDBs are the beneficiaries of the trust, and the trust provides that no other person will receive benefits from the trust until all of the disabled and chronically ill EDBs have died.

403(b) plans

The proposal has few specifics relating to 403(b) plans, which are generally treated like individual retirement accounts (IRAs) for 401(a)(9) purposes. But the proposal does request comments on whether the rules for 403(b) plans should align more closely with the rules for qualified plans. IRS is interested in possible administrative concerns, structural differences between qualified plans and 403(b) plans to take into account, and possible transition rules to ease implementation.

In addition, the proposal includes the following provisions:

- The exemption from the stretch-payment limitation for certain existing commercial annuity contracts would also apply to retirement income accounts for employees of church-related organizations — even if a commercial annuity isn’t used to pay benefits — as long as all other requirements of the exemption are satisfied.

- 403(b) plans (and governmental 457(b) plans) would be listed in the regulations as plans eligible to receive rollovers from other DC plans, implementing a statutory change from the Economic Growth Tax Relief Reconciliation Act of 2001.

DB plan beneficiary distributions mostly unchanged

The SECURE Act's 10-year rule does not apply to distributions to designated beneficiaries under a DB plan. The rules for distributions to DB plan beneficiaries are mostly (but not entirely) unchanged.

New default method requirement. The existing regulations allow a DB plan to specify which method applies or let the participant or beneficiary choose a method. The proposed regulation would retain these options, but with a tweak: The plan must include a default method for participants who make no election (similar to the new rules for DC plans that offer a choice). If the plan is silent, the stretch rule applies if the participant has a designated beneficiary, and the five-year rule applies if the participant doesn't designate one.

Age of majority under DB plans. The existing 401(a)(9) regulations provide that for DB plans, a child under age 26 who hasn't completed a specified course of education may be treated as not having reached the age of majority. If annuity payments to a minor child will switch to the surviving spouse when the child reaches the age of majority, the payments to the child are treated as payments to the spouse. This allows the plan to avoid violating 401(a)(9)'s prohibition on increasing benefits when the switch occurs. The proposal would permit — but not require — DB plans using the existing definition of the age of majority for this purpose to continue to do so (instead of adopting the new age of majority that applies to DC plans determining whether a participant's child is an EDB).

Other changes

Anti-cutback relief for eliminating noncompliant benefit options. Section 411(d)(6) prohibits eliminating optional payment forms for accrued benefits, except for those that create "significant burdens or complexities" for the plan. However, the current 401(a)(9) regulations include a provision that lets sponsors eliminate forms that don't comply with 401(a)(9), without violating the anti-cutback rules. The proposed rules don't contain similar language, but the absence of any discussion in the preamble could indicate that IRS doesn't view the change as significant, perhaps because the proposal retains the language that prohibits a plan from distributing benefits in a form that violates 401(a)(9).

Interaction of Section 436 benefit restrictions and 401(a)(9). Benefit restrictions under IRC Section 436 prevent severely underfunded DB plans and plans sponsored by employers in bankruptcy from making payments exceeding the single life annuity amount. Moderately underfunded plans also face accelerated payment restrictions. To prevent conflicts between 436 restrictions and the five-year rule for payments after an employee's death, the proposal would provide that payments from affected plans must begin by the fifth year after the employee's death in a form as accelerated as permitted. Once restrictions are lifted and lump sums are permitted, any remaining payments must be commuted to a lump sum.

New excise tax waiver for beneficiaries. When an employee or IRA owner subject to RMDs dies before receiving the required distribution for the year, the beneficiary must take the RMD by the end of that calendar year or pay an excise tax. The proposal would provide an automatic waiver of the excise tax for RMDs distributed by the beneficiary's tax filing deadline, including extensions.

No news on retiree lump sum windows

After several high-profile retiree lump sum windows starting in 2012, IRS announced in Notice 2015-49 that it intended to amend the 401(a)(9) regulations to permanently prohibit these programs. But in Notice 2019-18, IRS reversed course, saying it no longer intend to amend the regulations but would continue to study the issue. Sponsors offering retiree lump sum cashouts generally rely on the provision in Treasury Reg. 1.401(a)(9)-6, Q&A-14, allowing plans to pay "increased benefits that result from a plan amendment," even though its applicability to lump sum windows has never been confirmed. The proposal remains silent on the issue.

Applicability date

The proposed regulations would apply to RMDs relating to 2022 and later calendar years. For 2021, the preamble states that plans must rely on the existing regulations under 401(a)(9), but must take into account a reasonable, good-faith interpretation of the SECURE Act. The preamble states that compliance with the proposal for 2021 will show good-faith compliance with the statute, but doing so presumably isn't required.

Related resources

Non-Mercer resources

- Proposed regulations (Federal Register, Feb. 24, 2022)

Mercer Law & Policy resources

- Broad 'SECURE 2.0' retirement bill gets overwhelming House approval (March 30, 2022)
- SECURE, CARES acts change rules on required minimum distributions (April 7, 2020)
- SECURE Act set to become law (Dec. 19, 2019)

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