COMMITTEE REPORT:
RETIREMENT BENEFITS

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Proposed RMD Regulations Interpret the SECURE Act

A review of key provisions

The Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019[1] was enacted on Dec. 20, 2019 as part of the Further Consolidated Appropriations Act, 2020. The Internal Revenue Service released proposed regulations (proposed regs) under the SECURE Act on Feb. 24, 2022.[2] These are only proposed regs, so they may change when final regulations are issued.

Background

Prior to the SECURE Act, a designated beneficiary could stretch distributions of inherited retirement benefits or accounts over their life expectancy (life expectancy rule) if permitted under the terms of the governing plan document.[3] If the participant or individual retirement account owner (IRA owner) died on or after the date that required minimum distributions (RMDs) were required to begin, the designated beneficiary would take distributions over the longer of the remaining life expectancy of the decedent or the life expectancy of the beneficiary. A beneficiary is a designated beneficiary if the beneficiary is an individual. In the case of a qualified see-through trust, the oldest beneficiary of the trust is treated as the designated beneficiary for RMD purposes.[4]

The SECURE Act repealed the provision that allowed a designated beneficiary to take distributions over their full life expectancy and replaced that life expectancy rule with a new 10-year rule. As a result, effective for IRAs inherited after 2019, designated beneficiaries must generally take complete distribution of inherited retirement accounts by the end of the 10th calendar year following the year of the IRA owner's death.[5]

The SECURE Act created a new class of designated beneficiary: an eligible designated beneficiary (EDB).[6] A beneficiary is an EDB if at the time of the IRA owner's death the beneficiary:

- is the IRA owner's surviving spouse,
- is the IRA owner's minor child,
- is disabled,
- is chronically ill, or
- doesn't fall under any of the above categories but isn't more than 10 years younger than the IRA owner.[7]

An EDB may take distributions under the life expectancy rule. However, for an IRA owner's minor child, life expectancy payments are permitted only until the child reaches the age of majority, at which time distributions must then switch to the 10-year rule. To avoid having to consider different state laws, the proposed regs set the age of majority at 21.[8]

Rules for Trust Beneficiaries

A trust for the benefit of a disabled or chronically ill beneficiary may also use the life expectancy rule if, during the disabled or chronically ill beneficiary's lifetime, no distributions may go to anyone other than a disabled or chronically ill person. A trust for more than one disabled or chronically ill beneficiary is also permissible.[9]

The definition of "disabled" is the same as that for Social Security purposes. That is, an individual

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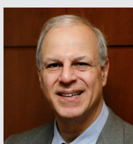

is considered disabled if they're unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or to be of long, continued and indefinite duration.[10]

Because it may be difficult to apply that test to younger individuals, the proposed regs provide that an individual under 18 is considered disabled if they have a medically determinable physical or mental impairment that results in marked and severe functional limitations that can be expected to result in death or to be of long, continued and indefinite duration.[11]

The proposed regs also provide a safe harbor whereby, if, as of the IRA owner's death, Social Security has determined that an individual is disabled, they'll be deemed to be disabled for this purpose.[12]

Planning opportunity: To take advantage of this, an IRA owner with a disabled child might leave the IRA in trust for the disabled child and other assets to or in trust for the other children.

Naming Trusts as Beneficiaries

The proposed regs facilitate naming trusts as beneficiaries of IRAs. Until now, if the trustees could accumulate some or all of the distributions from an inherited IRA, subsequent and remainder beneficiaries were counted as beneficiaries. For example, if a charity were a remainder beneficiary or even a contingent remainder beneficiary, the IRA owner was treated as having no designated beneficiary, because IRA benefits could be accumulated and subsequently paid to the charity. Permissible appointees were also counted.

There was an exception for a conduit trust in which all of the amounts the trustees received from the IRA had to be paid out to the current beneficiary on a current basis. In that case, the subsequent beneficiaries could be disregarded. However, in a conduit trust, the protection of the trust is lost over time as the amounts received from the IRA are distributed.

The proposed regs allow more flexibility by disregarding certain contingent remainder beneficiaries, clarifying that there may be additions to the class of beneficiaries and ignoring permissible appointees until the power of appointment (POA) is exercised in their favor.

A beneficiary whose interest is contingent on the death of a prior beneficiary whose sole interest is residual is disregarded.[13] For example, suppose a trust provides income to A, then remainder to B if B survives A, but if B doesn't survive A, then remainder to charity. Under the proposed regs, if B survives the IRA owner and has no interest in the trust during A's lifetime, then the charity is disregarded. However, to take advantage of this provision, there must be a prior remainder beneficiary who would take payments outright. That would sacrifice the protections of the trust if the prior remainder beneficiary took payments.

> In a major change, the proposed regs provide that a POA won't cause a trust to fail the identifiable requirement merely because the permissible appointees aren't identifiable.

The proposed regs make it clear that an addition to the class of beneficiaries, such as the birth of an additional grandchild in the case of a trust for the benefit of the IRA owner's grandchildren, won't cause the trust to fail the identifiability requirements. This will allow considerable flexibility in drafting.

POAs

Under the original proposed regs in 1987, there was some uncertainty as to how permissible appointees under a POA would be treated. In 2002, the IRS treated the oldest child as the designated beneficiary when each child had a POA exercisable in favor of anyone other than the child, their estate or creditors or anyone born in a year prior to the year of the oldest child's birth.[14] Because that ruling allowed a broad class of permissible appointees, planners

generally followed it and limited their POAs in the same manner.

Under the proposed regs, if a POA is exercised by Sept. 30 of the year following the year of the IRA owner's death in favor of one or more identifiable beneficiaries, those individuals will be treated as designated.[15]

Beneficiaries who are eliminated by Sept. 30 of the year following the IRA owner's death are disregarded. The proposed regs allow the class of permissible appointees to be restricted to identifiable beneficiaries by that date.[16] This will permit a beneficiary with a POA to narrow the class of permissible appointees to eliminate an unwanted beneficiary from the class of permissible appointees. The IRS previously allowed this situation in Private Letter Rulings 201203003 (Jan. 20, 2012) and 201840007 (Oct. 5, 2018).

In a major change, the proposed regs provide that a POA won't cause a trust to fail the identifiable requirement merely because the permissible appointees aren't identifiable.[17] Instead, if the power is exercised after Sept. 30 of the year following the IRA owner's death, the additional beneficiaries added pursuant to the exercise of the power are counted.[18] This should add considerable flexibility to POAs.

The proposed regs provide that a see-through trust won't fail the identifiability requirement merely because state law permits the trust to be modified, such as by reformation or decanting. A beneficiary removed by Sept. 30 of the calendar year following the IRA owner's death is disregarded, and a beneficiary added after that date is counted. If the additional beneficiary is added after Sept. 30 of the calendar year following the IRA owner's death, the rules governing beneficiaries added pursuant to a POA will apply.

More than half the states have decanting statutes. In addition, while the common law is sparse, a trustee with complete discretion to distribute principal may be able to decant a trust under common law in favor of one or more of the beneficiaries. It should also be possible to decant a trust to the extent authorized in the will or trust instrument. While decanting must be in favor of one or more of the beneficiaries of the existing trusts, so that additional beneficiaries may not be directly added, many decanting statutes allow POAs to be added in the new trust, which indirectly allows for additional beneficiaries.[19]

While the trust instrument referred to the action as a disclaimer rather than a decanting, the IRS in PLR 200537004 (Sept. 16, 2005) has allowed decanting pursuant to the terms of the instrument.

In prior PLRs, the IRS originally allowed reformation.[20] However, in more recent rulings, the IRS didn't allow reformations.[21] The proposed regs will provide additional flexibility in this regard.

Distributions for Beneficiaries

Commentators interpreted the SECURE Act's 10-year rule as a provision so that distributions are always optional for Year 1 through Year 9, and the beneficiary must fully distribute the inherited account by the end of Year 10. The proposed regs include provisions that are different from many commentators' interpretations of the SECURE Act, including the fact that beneficiary RMDs must be taken from Year 1 through Year 9 in certain cases.

Another important discrepancy between commentators' interpretations and the proposed regs is the "at least as rapidly" rule under Section 401(a)(9)(B)(i), which provides that when the IRA owner had reached their required beginning date (RBD), distributions to the beneficiary must be made "at least as rapidly as under the method of distributions being used … as of the date of [the IRA owner's] death."[22] Many practitioners thought this rule didn't carry over under the SECURE Act, but the proposed regs state that it still applies.

Additional clarifications include:

- **Distribution requirements for designated beneficiaries.** Under the SECURE Act, a designated beneficiary must take distributions under the 10-year rule, which requires the inherited IRA to be completely distributed by the end of the 10th calendar year following the IRA owner's death. Commentators thought that this rule was the same regardless of whether the IRA owner died before or after the RBD, which is April 1 of the year following the year the IRA owner attains age 72.

  However, under the proposed regs, in addition

to requiring complete distribution by the end of the 10th calendar year following the IRA owner's death, if the IRA owner dies on or after the RBD, distributions must be taken in Year 1 through Year 9 based on the beneficiary's life expectancy. If the IRA owner dies before the RBD, distributions in Year 1 through Year 9 aren't required.[23]

- **Distribution requirements for an EDB.** The proposed regs provide that if the IRA owner dies before the RBD and the beneficiary is an EDB, the terms of the IRA agreement may include a provision that allows the EDB to choose either the 10-year rule or the life expectancy rule, or default to either. If the IRA agreement is silent on this issue, the proposed regs default to the life expectancy rule.[24]

  Generally, when the IRA owner dies before the RBD, RMDs are taken under the life expectancy method, and the account must be fully distributed by the end of the 10th year.[25]

  When the IRA owner dies on or after the RBD, RMDs are taken under the life expectancy method, and the account must be fully distributed by the end of the 10th year. However, the period would be shorter than 10 years if the life expectancy period would have ended earlier than 10 years.[26]
- **Successor beneficiaries.** The proposed regs require that, if the IRA owner dies on or after the RBD and the beneficiary is a designated beneficiary or an EDB, successor beneficiaries must continue to take distributions that the designated beneficiary or EDB was scheduled to take.[27] Many commentators thought that the successor beneficiary would have gotten a new 10-year period for taking distributions on the death of the designated beneficiary or EDB.
- **Roth IRAs.** Because the RMD rules don't apply to Roth IRA owners, the post-RBD rules, including the "at least as rapidly" rules, don't apply to Roth IRA beneficiaries.

Special provisions apply to minor children of the IRA owner. For example, for a minor child, life expectancy distributions would switch to the 10-year rule when the child reaches age 21 or dies. And for spouse beneficiaries, whereas life expectancy distributions generally begin by Dec. 31 of the year that follows the year of the IRA owner's death, the starting date can be deferred until the year the decedent would have reached age 72 if that's later, and the owner died before reaching the RBD.

More to Come

The IRS is accepting comments on these proposed regs up to May 25, 2022. Formal comments may be submitted here: *www.regulations.gov/commenton/IRS-2022-0003-0001*. Until final regulations are issued, the proposed regs are what practitioners will use to administer RMDs. We'll keep you posted on any new developments.

Endnotes

1. Pub. L. 119-94 (116th Cong., 1st Session).
2. REG-105954-20.
3. Internal Revenue Code Section 401(a)(9)(B)(iii). All statutory references are to the Internal Revenue Code of 1986, as amended.
4. Treasury Regulations Section 1.401(a)(9)-4, Q&A 5.
5. IRC Section 401(a)(9)(H).
6. Section 401(a)(9)(H)(ii).
7. Section 401(a)(9)(E)(II).
8. Proposed Treas. Regs. Section 1.401(a)(9)-4(e)(3).
9. Section 401(a)(9)(H)(iv).
10. IRC Section 72(m)(7), Treas. Regs. Section 1.401(a)(9)-4(e)(4)(ii).
11. Prop. Treas. Regs. Section 1.401(a)(9)-4(e)(4)(iii).
12. Prop. Treas. Regs. Section 1.401(a)(9)-4(e)(4)(iv).
13. Prop. Treas. Regs. Section 1.401(a)(9)-4(f)(3)(ii).
14. Private Letter Ruling 200235038 (Aug. 30, 2002).
15. Prop. Treas. Regs. Section 1.401(a)(9)-4(f)(5)(ii)(A).
16. *Ibid.*
17. *Ibid.*
18. Prop. Treas. Regs. Section 1.401(a)(9)-4(f)(5)(ii)(B).
19. *E.g.*, New York Estates, Powers & Trusts Law Section 10-6.6(b).
20. PLRs 200620026 (May 19, 2006) and 200235038 through 200235041 (Aug. 30, 2002).
21. PLRs 201628004 (July 8, 2016) and 201021038 (May 28, 2010).
22. Section 401(a)(9)(B)(i).
23. Prop. Treas. Regs. Section 1.401(a)(9)-5(d)(1)(ii).
24. Prop. Treas. Regs. Section 1.401(a)(9)-3(c)(5)(ii) (iii).
25. *See supra* note 23.
26. *Ibid.*
27. Prop. Treas. Regs. Section 1.401(a)(9)-5(d)(1).