

BENEFITS BRIEF

NAVIGATING THE REQUIRED MINIMUM DISTRIBUTION RULES FOR 2020 AND THEREAFTER

September 2020

Note: This Benefits Brief updates the May 2020 version to clarify the post-death distribution rules as amended by the SECURE Act.

Two recent tax changes, one added as part of the SECURE Act passed in late 2019 and another included in the recently enacted CARES Act, will affect required minimum required distributions (“RMDs”) in tax-qualified retirement and Section 403(b) plans of for-profit and tax-exempt employers in 2020 and thereafter. In this Benefits Brief, we will provide a general overview of these changes, how they will affect administration for these plans for 2020 and following years, and provide suggested action items for plan sponsors and plan administrators.¹

Required Minimum Distributions – Pre-SECURE Act

The required minimum distribution rules are designed to assure that amounts accumulated in retirement plans are used for the support of the participant and his/her dependents in retirement rather than a tax-deferred vehicle to transfer wealth to a younger generation.

Under pre-2020 law, a participant who owns more than 5% of the plan sponsor, directly and through attribution, is required to commence distributions from the plan once he/she attains age 70 ½. A participant who owns less than 5% of the plan sponsor is required to commence distributions by the later of attainment of age 70 ½ or retirement.

The amount required to be distributed each year depends upon the age of the participant or, in the case of a deceased participant, whether he/she died before or after attaining age 70 ½. Properly structured, post-death distributions under pre-2020 law may be made over the life expectancy of the participant’s “designated beneficiary.” Suffice it to say that the rules governing actual commencement and the calculation of required payments are detailed and complex.

Failure to pay an RMD is both a disqualification defect for the plan and subjects the recipient to a 50% penalty tax to the extent a distribution is less than the required amount.

A plan may generally require earlier commencement and payment than the required minimum distribution rules require but a plan may not permit later commencement or later payment than permitted under those rules.

¹ The SECURE and CARES Acts also changed the required minimum distribution rules applicable to IRAs, however, a discussion of those changes is beyond the scope of this *Benefits Brief*. Also, special rules apply to governmental and multiemployer (union) plans but a discussion of those provisions is beyond the scope of this *Benefits Brief*.

SECURE Act Changes

The SECURE Act made two changes in the required minimum distribution provisions. First, effective with respect to participants who had not attained age 70 ½ as of December 31, 2019, the age at which RMDs must start is increased from age 70 ½ to age 72. This means a participant born after June 30, 1949 who is not a more than 5% owner is not required to start distributions until the later of age 72 or retirement.

The second change eliminated the ability to pay out post-death distributions from a defined contribution plan (e.g., a 401(k), profit sharing, money purchase pension, or 403(b) plan) over the life expectancy of the participant's "designated beneficiary" except in limited circumstances. A "designated beneficiary" is an individual who is designated as a beneficiary under the plan, even if the participant did not specifically designate him/her (e.g., a default individual beneficiary). Effective for participants who die after December 31, 2019, the entire balance must be paid from the plan to a "designated beneficiary" by December 31 of the year of the tenth anniversary of the participant's death unless the beneficiary is an "eligible designated beneficiary." This new limit on the payment term for a "designated beneficiary" applies irrespective of the participant's age at the time of death. Withdrawals are not required annually; rather the entire balance must simply be withdrawn by the December 31 deadline.

There are five categories of "designated beneficiaries" who are considered "eligible designated beneficiaries" for purposes of these rules:

- The participant's surviving spouse;
- The participant's minor child;
- A beneficiary who is considered disabled under the Internal Revenue Code;
- A beneficiary who is considered chronically ill under the Internal Revenue Code; and
- A beneficiary who is not more than 10 years younger than the participant.

Benefits to "eligible designated beneficiaries" may be paid after the participant's death over the beneficiary's life expectancy, with the exception of the participant's minor child; benefits to a participant's minor child can be paid over his/her life expectancy until he/she attains the age of majority, following which all remaining benefits must be paid out within ten years. As under current law, a surviving spouse may also defer commencement until the date the participant would have been required to commence his/her distributions.

Distributions to a beneficiary that is not a "designated beneficiary" (e.g., the participant's estate or a charity) must be completed by December 31 of the year of the fifth anniversary of the participant's death if the participant dies before the date required minimum distributions must commence; if RMDs had commenced by the participant's death, payments to a beneficiary other than a "designated beneficiary" can be made over the participant's life expectancy at the time of his/her death.

CARES Act Change

The CARES Act waives all required minimum distributions for defined contribution plans (e.g., 401(k), profit sharing, money purchase pension, and 403(b) plans) that would otherwise

be due in 2020. In other words, required minimum distributions are simply pushed back by one year for these plans.

Plan sponsors may permit participants to request a withdrawal of the 2020 required minimum distribution amount notwithstanding the waiver. If they choose to do so, those distributions are not subject to 20% mandatory federal income tax withholding and the plan administrator is not required to provide the eligible rollover explanation required before the distribution of non-RMD amounts.

Plan Sponsor and Plan Administrator Action Items

In our experience, most participants and beneficiaries of deceased participants elect a distribution soon after termination of employment or death, as applicable, so it is fairly rare a plan sponsor or administrator must contend with the RMD rules. These changes will, however, compel the plan sponsor and plan administrator to address practices and procedures with the plan's third party administrator and/or recordkeeper to assure compliance with these provisions going forward.²

Neither the Internal Revenue Code nor Department of Labor or Internal Revenue Service guidance explicitly requires notifying participants of these changes at this time, but we think it a good practice to promptly do so. Consideration should be given to distributing an update to the summary plan description (often referred to as a "summary of material modifications") for this purpose to obviate the need to distribute an explanatory notice now and an update to the summary plan description after the written plan amendment is executed.

Distribution forms may also need to be updated, including as the required explanation of the federal income tax consequences of the distribution. Most plan sponsors use the IRS safe harbor "model" explanation, which was just recently updated.

Plan amendments are not required at this time; rather the last day of the first plan year beginning on or after January 1, 2022 is the amendment deadline for the both the SECURE Act and CARES Act changes. Both amendments must reflect the manner in which the plan has been administered since January 1, 2020.

² Note, a plan may be drafted to require distributions earlier and over a shorter period of time than required under the required minimum distribution rules.

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