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SECURE 2.0 Required Minimum Distributions and DC Plan Lifetime Income

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The SECURE 2.0 Act of 2022 ("SECURE 2.0"), like the original SECURE Act of 2019 ("SECURE 1.0"), made significant changes to the required minimum distribution ("RMD") rules. The SECURE 2.0 changes generally allow for participants and beneficiaries to receive their distributions later and reduce penalties for participants who do not receive RMDs on a timely basis. These changes may impact all 401(k) plans, pension plans, other qualified retirement plans, 403(b) plans, and 457(b) plans.

In addition, SECURE 2.0 modifies the RMD rules to enhance lifetime income features that may encourage 401(k) and other defined contribution plans to offer participants the opportunity to use commercial annuity products to provide for lifetime income in their retirement.

Increased RMD Age

The RMD rules require participants to commence their distributions by April 1 of the calendar year following their attainment of a specified age (the "RMD Age") or, if later, their retirement, except in the case of 5% owners. SECURE 1.0 delayed the RMD Age from age 70½ to age 72 for participants who attained age 70½ after 12/31/2019. SECURE 2.0 further increases the RMD Age to age 73 (effective with respect to participants who turn age 72 after 12/31/2022 and before 1/1/2033), and later to age 75 (with respect to participants who turn age 74 after 12/31/2032).

Under SECURE 2.0, participants born in 1959 will have an RMD Age at both age 73 (because they attain age 72 in 2031) and age 75 (because they attain age 74 in 2033). However, this inconsistency should be resolved in a technical corrections bill or in IRS guidance well in advance of when participants born in 1959 attain either of these dates.

As the result of SECURE 2.0, participants who attain age 72 in 2023 will not be required to begin their distributions until they attain age 73 in 2024. The IRS has already issued transition relief for IRA providers with respect to individuals who turn age 72 in 2023 and have already taken their first distribution as an RMD. Notice

2023-23 provide that the IRS will not consider an RMD statement that was provided to a participant who turns 72 in 2023 to be incorrect if the provider issues a correction by April 28, 2023. The IRS has not yet issued similar transitional relief for employer plans that have already paid distributions as RMDs in 2023 (for example, Form 1099-R reporting, participant communications relating to RMD requirements, etc.) or provided any special rollover rules, as was provided with SECURE 1.0 and the CARES Act, which offered an RMD holiday for 2020.

As with SECURE 1.0, the requirement that pension plans actuarially adjust benefits that remain outstanding after age 70½ remains tied to age 70½ and is not affected by the increased RMD Age.

Exemption for Roth Accounts

Effective with respect to RMDs relating to taxable years beginning after 12/31/2023, SECURE 2.0 exempts Roth accounts in retirement plans from the RMD rules until the account owner dies. This extends a rule that was already applicable to IRAs to the 401(k) plan context.

Reduced Excise Taxes

Effective with respect to taxable years beginning after 12/29/2022, the excise tax that applies to failures to take RMDs when due is decreased from 50% to 25%, or to 10% if corrected within two years (and before IRS mails a notice of deficiency or assesses the tax).

Spousal Elections

Effective with respect to calendar years beginning after 12/31/2023, the surviving spouse of a deceased employee may elect to be treated as the deceased employee for purposes of the RMD rules. If the election is made, then the required beginning date will not be earlier than the date on which the employee would have reached the RMD Age, and if the surviving spouse dies before reaching that date, then the required beginning date will not be earlier than the date on which the surviving spouse would have reached the RMD Age.

Lifetime Income

SECURE 2.0 also changes the rules for annuity distributions from 401(k) and other defined contribution plans under the RMD rules.

Perhaps most importantly, SECURE 2.0 modifies the rules for Qualifying Longevity Annuity Contracts (QLACs).

QLACs are potentially a powerful tool for 401(k) plan participants to manage longevity risk—the risk that they will outlive their retirement savings. A QLAC is a deferred annuity that starts when the participant reaches an advanced age (not later than age 85).

With a QLAC, a participant uses a portion of their retirement plan to pay premiums on a deferred annuity. The participant can then manage their remaining funds over a fixed period from their retirement until they reach the age when the QLAC payments begin. In this way, the participant has assurance of lifetime income from their retirement funds even if they live to an advanced age and have exhausted their other retirement funds.

SECURE 2.0 instructs the Department of Treasury to revise its RMD regulations to expand the availability of QLACs by:

- Eliminating a 25% cap on the percentage of a participant's account balance that may be used to purchase a QLAC;
- Increasing the dollar limit on premiums for a QLAC from $125,000 to $200,000, and tying that limit to inflation going forward;
- Clarifying certain aspects of how QLACs work with joint and survivor annuities and qualified domestic relations orders; and
- Permitting employees to rescind their election of a QLAC within 90 days after purchase.

QLACs were first introduced by the IRS and Treasury as part of an amendment to the RMD regulations in 2014. While QLACs have been obscure to this point (with the notable exception of their use in the University of California's 403(b) plan), with the favorable changes of SECURE 2.0, QLACs may become much more popular going forward.

SECURE 2.0 also revises the RMD rules to permit defined contribution plans to offer the following features with respect to an annuity that has already commenced:

- Constant inflation adjustments of less than 5% per year.
- Lump sum full or partial cashouts of the remaining annuity payments (to be determined using reasonable actuarial methods and assumptions).
- Lump sum cashouts of the next 12 months of ongoing annuity payments.
- Payment of dividends or similar distributions after an annuity has commenced (to be determined using reasonable actuarial methods and assumptions).
- A lump sum death benefit equal to the consideration paid for the annuity less actual payments.

The increased dollar and percentage limitations are effective with respect to QLACs purchased or received on or after the date of enactment (12/29/2022). The other provisions are effective retroactively to 7/2/2014, when QLACs first became available under IRS regulations.

Plan sponsors who are considering offering of annuity products (QLAC or otherwise) through a defined contribution plan, should be mindful that they raise special fiduciary considerations. The DOL has created a safe harbor whereby this fiduciary responsibility will be satisfied if plan fiduciaries take certain steps, including engaging in an objective, thorough, and analytical search for appropriate annuity providers and concludes that, at the time of selection, the annuity provider is financially able to make benefit payments, and the cost of the contract is reasonable.

Distributing Partial Annuities

Effective 12/29/2022, SECURE 2.0 clarifies that a defined contribution plan may, consistent with the RMD rules, distribute an annuity that is not alone sufficient to satisfy the RMD requirements, and then perform an annual true-up calculation to determine the minimum required additional distribution in order to satisfy the RMD rules.