The COMMITTEE of ANNUITY INSURERS

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July 22, 2020

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Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2020-47) Room 5203
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Recommendations for 2020-21 Priority Guidance Plan

To whom it may concern:

We are writing on behalf of the Committee of Annuity Insurers (the "Committee") in response to the invitation in Notice 2020-47 for public recommendations of items to include on the 2020-2021 Priority Guidance Plan. The Committee is a coalition of life insurance companies formed in 1981 to participate in the development of federal policy with respect to tax, securities, ERISA, and banking law issues affecting annuities. The Committee's current 32 member companies represent over 80% of the annuity business in the United States. A list of the Committee's member companies is attached as Exhibit A.

Annuities are crucial to the retirement security of millions of Americans. Other than Social Security and defined benefit plans, annuities are the only means that Americans have to guarantee they will not outlive their retirement income. There are a number of issues on which guidance is needed to clarify how recent legislation applies to annuities that are issued as individual retirement annuities ("IRAs") and to qualified retirement plans.[1] Almost all of those issues relate to the required minimum distribution ("RMD") rules under section 401(a)(9). Guidance also is needed to eliminate certain longstanding barriers to the use of life annuities under the RMD regulations.

As Notice 2020-47 requests, we have grouped our guidance recommendations by subject matter and, within each subject matter, we have ordered each item in terms of our assessment of high, medium, or low priority. Our recommendations fall within three main categories:

[1] Except where the context requires otherwise, our references to "IRAs" include individual retirement accounts under section 408(a) as well as individual retirement annuities under section 408(b). Unless otherwise indicated, "section" means a section of the Internal Revenue Code of 1986, as amended ("Code").

I. **CARES Act** – Congress enacted the Coronavirus Aid, Relief, and Economic Security (CARES) Act on March 27, 2020.[2] Additional guidance is needed with respect to the provisions of the CARES Act that waive RMDs for 2020.

II. **SECURE Act –** Congress enacted the Setting Every Community Up for Retirement Enhancement (SECURE) Act on December 20, 2019.[3] Guidance is needed with respect to the amendments the SECURE Act made to the RMD rules that apply after death. Some of those issues are particular to annuity products, but many of the issues implicate IRAs and qualified plans more broadly.

III. **Longstanding RMD Barriers to Life Annuities –** Certain aspects of the current RMD regulations discourage and, in some cases, effectively prohibit individuals from receiving their benefits from qualified plans and IRAs as a life annuity. There is a pressing need for guidance to eliminate these barriers. The issues are discussed briefly at the end of this letter and more extensively in Exhibit B.

Almost all of the items on which we are recommending guidance relate to the recently-enacted legislation mentioned above. Guidance on those issues is greatly needed in order to clarify ambiguities and facilitate compliance with the new laws. More generally, all of the issues we have identified herein affect potentially millions of individual taxpayers who own IRAs or participate in qualified plans, as well as the issuers, sponsors, and administrators of those arrangements. Our guidance recommendations are not controversial and would reduce burdens on taxpayers to varying extents, such as by making it easier for individuals and service providers to understand how the RMD rules apply to the annuity products they use to foster retirement security. Our recommendations would provide guidance where no guidance currently exists or would simplify existing rules, providing bright lines that will be easy to administer by taxpayers and the Internal Revenue Service ("IRS").

In addition, the portion of our guidance request relating to long-standing RMD barriers to life annuities (item III. above) would modify and improve rules that are unnecessarily burdensome because they hamper retirement security without achieving a compelling policy goal. For the same reasons, modifying those rules would be fully consistent with Executive Order 13777, which directs the Treasury Department to identify regulations that are "outdated, unnecessary, or ineffective,"[4] as well as with Executive Order 13789, which promotes "useful, simplified tax guidance" to taxpayers.[5]

The remainder of this letter sets forth our specific recommendations for guidance.

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[2] Pub. L. No. 116-136.

[3] The SECURE Act was enacted as Division O of the Further Consolidated Appropriations Act, 2019, Pub. L. No. 116-94. Our citations to the SECURE Act are to sections within such Division O.

[4] Executive Order 13777, 82 Fed. Reg. 12,285 (Mar. 1, 2017).

[5] Executive Order 13789, 82 Fed. Reg. 19,317 (Aug. 26, 2017).

I. CARES ACT GUIDANCE ITEMS

A. Extended Rollover Relief – *HIGH PRIORITY*

Background and problem: In Notice 2020-51, the IRS provided rollover relief with respect to provisions of the CARES Act that waive RMDs for 2020 and provisions of the SECURE Act that change the required beginning date ("RBD") for taking RMDs.[6] In relevant part, the Notice extends the 60-day rollover period for certain distributions from IRAs and qualified plans to August 31, 2020, with respect to distributions in 2020 that would have been RMDs in 2020 but for the CARES Act or SECURE Act. In addition, the Notice waives the one-rollover-per-year limitation and the non-spouse indirect rollover prohibition that otherwise apply to IRAs under section 408(d)(3)(B) and (C), respectively, if two conditions are met. First, the distribution must have been one that would have been treated as an RMD in 2020 but for the CARES Act or SECURE Act. Second, the distribution must be repaid to "the distributing IRA" by August 31, 2020 (emphasis added). Although this rollover relief was greatly appreciated, it also was unnecessarily limited in scope.

First, the extension of the 60-day rollover period was shorter than the extension the IRS provided in connection with the RMD waiver that applied in 2009.[7] The IRS provided greater relief for 2009 even though the corresponding statutory change was enacted at the end of the prior year, in 2008.[8] In contrast, the CARES Act was enacted on March 27, 2020, three full months into the calendar year to which the RMD waiver applied. This would seem to justify a longer relief period for rollovers than the IRS provided in 2009, not a shorter one.

Second, the relief that Notice 2020-51 provides from the one-rollover-per-year limitation and the non-spouse rollover prohibition is conditioned on the distribution being repaid to the same IRA. In some cases, this may be impossible. For example, the original IRA may no longer exist, such as in the case of an individual who transferred their IRA to another provider. Alternatively, the terms of the original IRA may not allow for repayments, such as in the case of a single premium annuity issued as an IRA. Individuals who find themselves in these situations should not be barred from the relief that the Notice extends to other taxpayers.

Guidance request: The Committee requests guidance providing that in the case of an individual who received a distribution that would have been an RMD in 2020 but for section 2203 of the CARES Act or section 114 of the SECURE Act:

(1) The recipient may repay the distribution even if the repayment is made more than 60 days after the distribution, provided that the repayment is made no later than December 31, 2020, and

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[6] Section 2203(a) of the CARES Act and section 114 of the SECURE Act, respectively.

[7] *See* Notice 2009-82, 2009-41 I.R.B. 491 (extending the same deadline until the end of November 2009).

[8] *See* section 201(a) of the Worker, Retiree, and Employer Recovery Act of 2008, Pub. L. No. 110-458 (enacted on December 23, 2008, and applicable for the 2009 calendar year).

(2) In the case of a non-spouse IRA beneficiary or an individual who would be subject to the one-rollover-per-year limitation, the recipient may repay the distribution to an IRA other than the distributing IRA by the deadline referenced in item (1) above, provided that the original IRA no longer exists, or the terms of the original IRA do not allow the amount to be repaid, such as in the case of a single premium individual retirement annuity.

II. SECURE ACT GUIDANCE ITEMS

A. RMDs: At-Least-As-Rapidly Rule – *HIGH PRIORITY*

Background and problem: Prior to the SECURE Act, if an employee died before their entire interest had been fully distributed and the death occurred before the employee's RBD, section 401(a)(9)(B)(ii) required the entire remaining interest to be distributed within 5 years of the employee's death (the "5-year rule"). Exceptions to this rule applied under subparagraph (B)(iii) (the "stretch rule") and (B)(iv) (the "spousal deferral rule") in cases where the employee had a "designated beneficiary." If the employee died on or after their RBD, section 401(a)(9)(B)(i) required that any remaining interest must be distributed at least as rapidly as under the method of distribution being used when the employee died (the "at-least-as-rapidly rule"). This rule applied whether or not the employee had a designated beneficiary.

The SECURE Act appears to eliminate the distinctions described above regarding death before the RBD and death on or after the RBD in any situation where the employee has a "designated beneficiary."[9] In such cases, and subject to an exception for any "eligible" designated beneficiary ("EDB"), new section 401(a)(9)(H)(i) provides that if an employee dies before their entire interest has been fully distributed:

(1) the 5-year rule of section 401(a)(9)(B)(ii) shall apply, but "5 years" is replaced with "10 years;" and

(2) the rule in (1) above applies whether or not distribution of the employee's interest has begun under the RMD rules, *i.e.*, regardless of whether the employee dies on, before, or after their RBD.

The SECURE Act did not amend the at-least-as-rapidly rule of section 401(a)(9)(B)(i). As indicated above, prior to the SECURE Act the at-least-as-rapidly rule applied in situations where the employee died on or after the RBD and regardless of whether the employee had a designated beneficiary. But the SECURE Act eliminates the relevance of the RBD for purposes of the RMD rules that apply after death in any case involving a designated beneficiary, instead imposing the 10-year rule in all such cases. In effect, the new 10-year rule (including its exception for EDBs) supersedes the at-least-as-rapidly rule if the employee has a designated beneficiary. Thus, the at-least-as-rapidly rule remains applicable only in cases where an employee does not have a designated beneficiary, just as the 5-year rule continues to apply only

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[9] See the introductory clause of section 401(a)(9)(H)(i), stating that the new rules apply "[e]xcept in the case of a beneficiary who is not a designated beneficiary."

in that circumstance (for example, where no beneficiary is named or the beneficiary is a charity or the decedent's estate).

Despite the foregoing, the Committee has heard questions about whether the at-least-as-rapidly rule continues to apply in addition to the 10-year rule in cases involving a designated beneficiary. For example, assume that an employee dies after their RBD and has a designated beneficiary who is not an EDB. The new 10-year rule clearly applies in this situation. The question is whether the at-least-as-rapidly rule also applies, so that during the 10-year period the beneficiary must continue receiving distributions at least as rapidly as they were being made before the employee died. We think the answer is no.

As discussed above, the SECURE Act amendments to section 401(a)(9) provide that in any case involving a designated beneficiary (1) the 5-year rule applies but using a 10-year period rather than a 5-year period, and (2) this rule applies regardless of when the employee dies in relation to their RBD. This clearly eliminates the relevance of the RBD when determining the distribution period for RMDs to a designated beneficiary after the employee's death. Moreover, the 5-year rule has never required any distributions to be made before the end of the 5-year period. The fact that the SECURE Act substitutes 10 years for 5 years when applying this rule to a designated beneficiary does not change this.

Guidance request: The Committee requests guidance clarifying that in situations where the 10-year rule of section 401(a)(9)(ii) (as modified by section 401(a)(9)(H)(i)) applies to a beneficiary's interest in an IRA or plan, the at-least-as-rapidly rule of section 401(a)(9)(B)(i) does not also apply.

B. RMDs: Spousal Beneficiaries – *HIGH PRIORITY*

Background and problem: New section 401(a)(9)(E)(ii) (flush language) states that the determination of whether a designated beneficiary is an EDB is made as of the date of the employee's death. This could mean that a designated beneficiary who is the owner's former spouse is not an EDB. For example, if the joint annuitant under a joint and survivor annuity is the owner's spouse on the annuity starting date, but the couple later divorces, the former spouse may not be an EDB when the owner dies. In such case, unless the former spouse qualifies under another category of EDB at the time of the owner's death (such as being less than 10 years younger than the owner), the 10-year rule would apply when the owner dies. The remaining life-contingent payments based on the former spouse's life would not comply with the new rules.

In the case of qualified plans, the current regulations generally treat a former spouse as the owner's spouse for RMD purposes if a qualified domestic relations order (QDRO) provides the former spouse with rights to the benefits.[10] This could mean that in such cases involving a QDRO, a former spouse is an EDB. However, QDROs relate only to qualified plans and not IRAs, and although the current regulations provide that IRAs are subject to the same RMD rules

[10] Treas. Reg. section 1.401(a)(9)-8, Q&A-6(a).

as qualified plans,[11] it is unclear whether this provision is sufficient to extend the QDRO concept to IRAs for RMD purposes without further guidance.

Guidance request: The Committee requests guidance confirming that if annuity payments have begun over the joint lives of an IRA owner or plan participant and his or her spouse who is more than 10 years younger, the couple later divorces, and the owner or employee subsequently dies, the surviving ex-spouse may be treated as an EDB for purposes of section 401(a)(9). Absent such guidance, it may be difficult to ensure compliance with the RMD rules in any situation involving a joint and survivor annuity with a spousal joint annuitant. The Committee believes that such joint and survivor annuities should be encouraged, as they provide critical protections for spousal beneficiaries, even in situations involving divorce. The RMD rules should not discourage the election of such protections through lack of clarity or, worse, by deeming such annuity payouts non-compliant in the event of divorce.

C. RMDs: Required Accelerations of Annuity Payments – *HIGH PRIORITY*

Background and problem: The SECURE Act's changes to the post-death RMD rules present a number of challenges for annuitized forms of retirement benefits paid from IRAs and defined contribution plans. Two aspects of the new rules, in particular, contribute to those challenges:

- *At-least-as-rapidly rule* – Under prior law, if an IRA owner or plan participant died after annuitizing any portion of their account balance, the remaining annuity payments could continue as scheduled, pursuant to the at-least-as-rapidly rule in section 401(a)(9)(B)(i).[12] Under the new law, all designated beneficiaries instead must receive their benefits in accordance with either the 10-year rule of section 401(a)(9)(ii) (as modified by section 401(a)(9)(H)(i)) or, if available, the stretch rule of section 401(a)(9)(B)(iii) (as modified by section 401(a)(9)(H)(ii)), regardless of when the owner dies in relation to their RBD.

- *EDB status determined at death* – The new SECURE Act rules also provide that a designated beneficiary's status as an EDB is determined as of the date of the owner's death. Thus, an IRA owner or plan participant could have an EDB when annuity payments commence but no longer have an EDB at their death.

In light of these aspects of the new rules, it will be more difficult to structure annuity payments during the owner's life that will <u>always</u> comply with the RMD rules after death. As a result, it may become necessary to modify annuity payments after the owner's death by accelerating them so they will be paid within the timeframe that the new rules require. Consider the following example:

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[11] Treas. Reg. section 1.408-8, Q&A-1(a).

[12] This was the case regardless of whether the annuitization occurred before, on, or after the RBD. *See* Treas. Reg. section 1.401(a)(9)-6, Q&A-10(a) (if annuity payments commence before the RBD, the annuity starting date is treated as the RBD for purposes of the at-least-as-rapidly rule).

> *Example:* An IRA owner annuitizes in 2020 for his single life with a period certain of 25 years, which does not exceed the permissible distribution period under the current regulations.[13] He names his spouse as the sole beneficiary and expects that she will "stretch" any benefits after his death because she will be an EDB and the remaining period certain will not exceed her life expectancy. However, the spouse dies five years after payments start to the owner, and the owner then names his adult son as the new beneficiary, who is not an EDB. The owner dies five years later, with 15 years remaining in the period certain. The at-least-as-rapidly rule is no longer available. In addition, because the son is not an EDB, he is subject to the new 10-year rule. The remaining 15-year term of the annuity will not comply with the RMD rules.

In the situation described above, the annuity payments after the owner's death will need to be paid out faster than the 15 years remaining in the period certain. This, in turn, will require some type of acceleration of the remaining payments, such as a commutation or a shortening of the payment period. Under the current RMD regulations, commutations and similar accelerations of annuity payments must satisfy the following requirements relating to the general rule that annuity payments be "nonincreasing:"[14]

- *Minimum income threshold test ("MITT"):* Any contract that provides the possibility of increasing payments (such as a commutation or shortening of the payment period) must pass a test in the regulations that has become known as the "minimum income threshold test," or MITT, which applies as of the annuity starting date (and not as of the date of the acceleration).[15]

- *Payment acceleration rule:* A shortening of the payment period, or a full or partial commutation, is allowed only if a special test is satisfied at the time of the acceleration, in addition to the MITT being satisfied at the annuity starting date. Specifically, the change must cause the total future expected payments (including any lump sum received) to decrease, with the calculation being based on certain assumptions in the regulations.[16]

In light of the SECURE Act's changes to the RMD rules discussed above, it is very likely that more annuity payouts will need to be modified after they start in order to comply with the new rules. This means that more contracts could become subject to the MITT and the payment acceleration rules discussed above. In many of those situations, the insurance company and the individual may not have contemplated the future need to modify the annuity payments, and therefore may not have anticipated a need to satisfy the MITT at the annuity starting date or may be unable to satisfy the payment acceleration rule at the time of the acceleration. Under prior

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[13] *See* Treas. Reg. section 1.401(a)(9)-6, Q&A-3(a) (limiting the permitted period certain under an annuity to the life expectancy determined under the Uniform Lifetime Table).

[14] *See* Treas. Reg. section 1.401(a)(9)-6, Q&A-1(a).

[15] *See* Treas. Reg. section 1.401(a)(9)-6, Q&A-14(c) (introductory paragraph). The MITT and other problems with the MITT are discussed beginning on page 15, *infra*, and in Exhibit B.

[16] Treas. Reg. section 1.401(a)(9)-6, Q&A-14(e)(4).

law, an acceleration could be avoided if it did not satisfy the payment acceleration rule. In contrast, the new RMD rules may <u>require</u> the acceleration of annuity payments.

Guidance request: The Committee requests guidance providing that an acceleration of annuity payments required to comply with section 401(a)(9)(H) will not be treated as a prohibited increase in annuity payments irrespective of whether the acceleration satisfies the requirements of Treas. Reg. section 1.401(a)(9)-6, Q&A-14(c) and (e), which set forth the MITT and the payment acceleration rule, respectively. Without such relief, taxpayers may find themselves in situations where, despite their best planning and efforts to comply with the new RMD rules, they inadvertently violate those rules and become subject to the 50% excise tax under section 4974. In addition, any modifications to annuity payments that may be needed to comply with the SECURE Act's new requirements for post-death RMDs would result only in the acceleration of those payments, thereby accelerating the obligation to pay federal income tax and limiting (or eliminating) tax deferral under the IRA or plan.

D. IRA Annuity Policy Forms – *HIGH PRIORITY*

1. Adequate Time to Amend IRA Annuity Contracts

Background and problem: Annuity issuers will need adequate time to prepare IRA contract endorsements reflecting the SECURE Act, go through the state insurance approval process, and then deliver contract endorsements to contract owners. Retirement plans and the issuers of annuity contracts to such plans face very similar challenges. Section 601 of the SECURE Act provides relief to retirement plans and contracts issued in connection with such plans. In substance, that relief allows qualified plans and contracts to defer until December 31, 2022 (or such later date as the Secretary of Treasury may prescribe) making amendments to a retirement plan (or contract) that are required by the SECURE Act or any Treasury or DOL regulation issued under that act, provided that certain conditions are met. First, the plan (or contract) must be operated during the relevant period as if the plan amendment were in effect, and second, the amendment must apply retroactively for such period. In general, the relevant period means the period between the effective date of the legislative or regulatory change and the earlier of December 31, 2022, and the date the plan (or contract) amendment is adopted.

Guidance request: The Committee requests that the Treasury Department and IRS announce as soon as possible that IRA issuers will be allowed the same period to provide amended IRA endorsements as accorded retirement plans and contracts issued to such plans under the SECURE Act.

2. Publication of Updated Lists of Required Modifications

Background and problem: Many member companies of the Committee rely on the Lists of Required Modifications ("LRMs") for traditional, Roth, and SIMPLE IRAs to create endorsements for the annuity contracts they issue as IRAs. These endorsements can then be submitted to the IRS for prototype approval with the expectation of a seamless approval process. In addition, those companies who choose not to obtain prototype approval can be comfortable their endorsements accurately reflect the IRS's views on the form requirements applicable to IRAs by incorporating the LRMs into their annuity endorsements.

Guidance request: The Committee requests prompt publication of updated LRMs for annuity contracts that are issued as traditional, Roth, and SIMPLE IRAs, reflecting the relevant SECURE Act changes.

3. Publication of "Snap-on" Model IRA Amendments

Background and problem: Under current procedures, annuity issuers that have previously obtained prototype approval of their IRA endorsements and amend those endorsements to comply with changes in the law must resubmit the endorsements in order for the prototype approval to remain in place, even if the amendments use the language of the LRMs. The Committee believes that LRMs also could serve as pre-approved model language that could be added to prototype IRA annuity forms. Under this approach, the IRS would be able to control the form of prototype IRA annuity contracts, and provide a mechanism to assure that contracts are correctly updated to reflect the changes made by the SECURE Act, without having to review and approve again forms it has already approved. This approach would save time, money, and resources for both the IRS and insurance companies, as well as benefit IRA contract owners through more rapid reflection of the SECURE Act changes in their contracts.

Guidance request: The Committee requests prompt publication of pre-approved model amendments reflecting the SECURE Act amendments applicable to annuity contracts that are issued as traditional, Roth, and SIMPLE IRAs, which, if added to a previously-approved prototype IRA form, would allow the prototype approval to remain in effect without the need to re-apply for prototype approval.

4. Publication of Model IRA Annuity Endorsements

Background and problem: We expect the IRS will issue new model IRA forms for traditional, Roth, and SIMPLE IRA accounts. The IRS has issued only one model endorsement for individual retirement annuities, Form 5305-RB for Roth IRA annuities. The IRS announced in Rev. Proc. 2010-48 that it would issue two new model IRA forms for annuities, *i.e.*, Form 5305-B (Individual Retirement Annuity Endorsement) and Form 5305-SB (SIMPLE Individual Retirement Annuity Endorsement), but those model forms have never been issued.

Guidance request: The Committee requests publication of an updated Form 5305-RB and issuance of a model Individual Retirement Annuity Endorsement and a model SIMPLE Individual Retirement Annuity Endorsement, all reflecting SECURE Act changes.

E. Transitional Implementation of the SECURE Act – *MEDIUM PRIORITY*

Background and problem: The SECURE Act became law on December 20, 2019, and made sweeping and complex changes to the RMD rules, most of which became effective less than two weeks later, on January 1, 2020. Shortly thereafter the COVID-19 crisis struck, requiring significant Treasury and IRS resources to be shifted to other priorities. As a result, although the Treasury Department and IRS have been able to issue some helpful guidance regarding the SECURE Act changes, the scope of that guidance has been very limited. For example, virtually no guidance has been provided on the SECURE Act changes to the post-death RMD rules.

Guidance request: The Committee requests that, as has been done in other situations where changes in the law have become effective shortly after enactment, the Treasury Department and IRS announce, as soon as possible, that taxpayers can rely on a reasonable, good faith interpretation of the provisions of the SECURE Act affecting IRAs and qualified plans.

F. RMDs: Disabled and Chronically Ill Beneficiaries – *MEDIUM PRIORITY*

Background and problem: The SECURE Act amended the RMD rules under section 401(a)(9) to provide that only an "eligible designated beneficiary" (EDB) can stretch their inherited benefits over life or a period not extending beyond their life expectancy.[17] The new rules define an EDB as including any designated beneficiary who is (1) disabled within the meaning of section 72(m)(7),[18] or (2) a chronically ill individual within the meaning of section 7702B(c)(2), except that the requirements of subparagraph (A)(i) thereof shall be treated as met only if there is a certification that, as of "such date," the period of inability described therein is an indefinite one that is reasonably expected to be lengthy in nature.[19] The new rules provide that the determination of whether a designated beneficiary is an EDB "shall be made as of the date of death of the employee."[20] Guidance is needed regarding what information IRA issuers and plan administrators need to obtain in order to confirm a beneficiary's status as disabled or chronically ill under the foregoing provisions.

Guidance request: The Committee requests guidance clarifying that:

(1) An IRA issuer or a plan may treat a designated beneficiary as disabled or as a chronically ill individual for purposes of the foregoing rules if the issuer or plan, as applicable, obtains a signed certification from the beneficiary that he or she satisfied the applicable statutory requirements;

(2) In the case of an individual account balance in an IRA or plan that has not been annuitized, the certification described in item (1) above must attest to the beneficiary's satisfaction of the foregoing requirements as of the date of the owner or employee's death; and

[17] Section 401(a)(9)(H)(ii).

[18] Section 401(a)(9)(E)(ii)(III). Section 72(m)(7) states that an individual is considered to be disabled if "he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration." This section also states that an individual is not considered disabled "unless he furnishes proof of the existence thereof in such form and manner as the Secretary may require."

[19] Section 401(a)(9)(E)(ii)(IV). For purposes of Code section 7702B(c)(2)(A), the certification of a chronically ill individual must be provided at least every 12-months by a "licensed health care practitioner" within the meaning of section 7702B(c)(4).

[20] Section 401(a)(9)(E)(ii) (flush language).

(3) In the case of annuitized benefits that satisfy the requirements of Treas. Reg. section 1.401(a)(9)-6, the certification described in item (1) above can attest to satisfaction of the foregoing requirements as of the date the annuity payments commence, if earlier than the date of the owner or employee's death, and in such case the beneficiary will be treated as an EDB for purposes of the RMD rules.

With respect to item (3) above, we submit that it is very unlikely that an individual who satisfies the requirements to be treated as disabled or chronically ill as of the annuity starting date would recover from the relevant condition in a manner that would render them unable to satisfy those requirements as of the date of the owner or employee's death. As a result, the requested guidance likely would have little or no effect on the payment of RMDs. It would, however, provide a helpful clarification so that annuitants can be certain that any joint and survivor annuity payments they elect with a disabled or chronically ill beneficiary as the joint annuitant will remain RMD-compliant for the entire duration of the annuity payout, *i.e.*, that after the employee's death any survivor annuity payments to such a joint annuitant will be permitted.

G. RMDs: Trusts Named as Beneficiaries – *MEDIUM PRIORITY*

Background and problem: For RMD purposes, a "designated beneficiary" is "any <u>individual</u> designated as a beneficiary by the employee."[21] Thus, a non-individual – such as a trust – generally cannot be a designated beneficiary for RMD purposes. However, the current regulations provide "see-through" treatment for trusts that meet certain requirements.[22] If such treatment applies, the beneficiaries of the trust, rather than the trust itself, "will be treated as having been designated as beneficiaries of the employee under the plan for purposes of determining the distribution period under Code § 401(a)(9)."[23]

If a see-through trust is named as the IRA or plan beneficiary and the trust has multiple beneficiaries, the current regulations generally prohibit the trust from utilizing the "separate account" rules in the regulations that apply in other situations involving multiple beneficiaries.[24] Those separate account rules otherwise allow RMDs to be determined separately for each designated beneficiary.[25] Without the benefit of the separate account rules, if a see-through trust has multiple beneficiaries the required distribution period for all the trust beneficiaries is based

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[21] Section 401(a)(9)(E)(i) (emphasis added).

[22] Specifically, (1) the trust must be a valid trust under state law, or would be but for the fact that there is no corpus, (2) the trust must be irrevocable or, by its terms, become irrevocable upon the owner's death, (3) the beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the owner's benefit must be identifiable, and (4) certain documentation must be provided. In addition, all the beneficiaries of the trust must be individuals. Treas. Reg. section 1.401(a)(9)-4, Q&A-3 and Q&A-5(b).

[23] Treas. Reg. section 1.401(a)(9)-4, Q&A-5(a).

[24] Treas. Reg. section 1.401(a)(9)-4, Q&A-5(c). The separate account rules are set forth in Treas. Reg. section 1.401(a)(9)-8, Q&A-2.

[25] Treas. Reg. section 1.401(a)(9)-8, Q&A-2.

on the trust beneficiary with the shortest life expectancy; the other (younger) trust beneficiaries are ignored for this purpose.[26]

This treatment of see-through trusts with multiple beneficiaries presents a number of issues in light of the SECURE Act amendments to section 401(a)(9). Pursuant to those amendments, only EDBs can stretch their inherited benefits over life or life expectancy. Other types of designated beneficiaries are subject to a 10-year distribution rule. Prior to the SECURE Act, such distinctions between types of designated beneficiaries did not exist. Now that EDBs and non-EDBs are subject to different rules, the inability to apply separate accounting concepts to see-through trusts with multiple beneficiaries could lead to odd results, as illustrated in the following examples:

- *Example 1:* An IRA owner dies in 2020 at age 75 and a see-through trust is the named beneficiary. The owner's spouse and their two healthy (not disabled or chronically ill) adult children are the sole beneficiaries of the trust. Under the current regulations described above, the life expectancy of the spouse (who is an EDB) would be used to determine the required distribution period for <u>all</u> the trust beneficiaries, because she has the shortest life expectancy. Because the spouse is an EDB, the benefit for all three trust beneficiaries apparently could be stretched over the spouse's life expectancy, even though the adult children would have been subject to the 10-year rule if they had been named beneficiaries directly.

- *Example 2:* An IRA owner dies in 2020 at age 75 and a see-through trust is the named beneficiary. The owner's two healthy children, ages 10 and 30, are the sole beneficiaries of the trust. Under the current regulations described above, the life expectancy of the older beneficiary (who is <u>not</u> an EDB) would be used to determine the required distribution period for both beneficiaries. Thus, it appears that the new rules for non-EDBs apply to the entire interest, including that of the minor. If this is correct, the entire interest must be distributed by the end of 2030, and the minor loses the ability to stretch his benefit until he reaches majority, then apply the 10-year rule thereafter.

These are just two examples of the results that could arise under the new SECURE Act rules based on how the current regulations treat see-through trusts. Some of those results could be viewed as inconsistent with the intent of the SECURE Act, such as facilitating the ability of a non-EDB to "stretch" inherited benefits for longer than 10 years. This, in turn, raises questions about the continued availability of the see-through trust rules in the current regulations.

Guidance request: The Committee requests guidance confirming that the see-through trust rules of Treas. Reg. section 1.401(a)(9)-4, Q&A-5, continue to apply after the SECURE Act. However, those rules should be amended to eliminate the current prohibition on the use of separate accounting by trust beneficiaries under A-2 of Treas. Reg. section 1.401(a)(9)-8.

Removing this prohibition would facilitate proper administration of the SECURE Act by ensuring that EDBs – and only EDBs – can "stretch" their inherited benefits. It also would be

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[26] Treas. Reg. section 1.401(a)(9)-4, Q&A-5(c); Treas. Reg. section 1.401(a)(9)-5, Q&A-7(a).

consistent with the rule the SECURE Act added to section 401(a)(9)(H)(iv) and (v), which applies similar separate accounting concepts to certain multi-beneficiary trusts benefitting disabled or chronically ill beneficiaries. In that regard, there is nothing in the Code, either before or after the SECURE Act, that would preclude separate accounting concepts from being applied more broadly to trust beneficiaries who are not disabled or chronically ill.

H. RMDs: Beneficiaries Who Are Minors – *MEDIUM PRIORITY*

Background and problem: Under new section 401(a)(9)(E)(ii)(II), the child of an employee or an IRA owner is an EDB if the child is a designated beneficiary and has not reached majority. A child who is an EDB under this rule ceases to be an EDB as of the date the child reaches majority and the remaining interest must be distributed under the 10-year rule.[27] The new provision cross-references section 401(a)(9)(F) for the meaning of "majority." That section addresses the treatment of certain payments made to children but does not define "majority." The regulations, however, provide that for purposes of section 401(a)(9)(F) "a child may be treated as having not reached the age of majority if the child has not completed a specified course of education and is under the age of 26."[28] More generally, it appears that federal law, not state law, controls for purposes of the meaning of "majority."[29]

The IRS website states that for purposes of section 401(a)(9)(E)(ii)(II) a designated beneficiary who is a child of an employee shall be treated as having reached the age of majority when the child attains age 18.[30] While that posting is helpful, the website is not official IRS guidance on which taxpayers may rely. In addition, the website does not address whether a child may be treated as having not reached the age of majority if the child has not completed a specified course of education and is under the age of 26, as provided in the regulations under section 401(a)(9)(F), even though the new SECURE Act rule cross-references that section.

Guidance request: The Committee requests guidance that for purposes of section 401(a)(9)(E)(ii)(II) a designated beneficiary who is a child of an IRA owner or an employee (1) shall be treated as having reached the age of majority when the child attains age 18, and (2) may be treated as not having reached the age of majority if the child has not completed a specified course of education and is under the age of 26.

I. RMDs: Grandfathering Issues Affecting QLACs and DIAs – *LOW PRIORITY*

Background and problem: The SECURE Act provides that its amendments to the post-death RMD rules do not apply to a "qualified annuity" that meets certain requirements.[31] As

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[27] Section 401(a)(9)(E)(iii).

[28] Treas. Reg. section 1.401(a)(9)-6, Q&A 15.

[29] *See* Borbonus v. Commissioner, 42 T.C. 983 (1964); Henry v. Commissioner, 76 T.C. 455 (1981).

[30] *See* https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-required-minimum-distributions-rmds (stating that after the SECURE Act "minor children must still take remaining distributions within 10 years of reaching age 18.").

[31] Section 401(b)(4) of the SECURE Act.

relevant here, one of those requirements is that if annuity payments did not start to the employee before December 20, 2019, the employee must have made an "irrevocable election" before that date as to the "method and amount" of the annuity payments to the employee or any designated beneficiaries.[32] This rule facilitates grandfathering treatment for deferred income annuities ("DIAs"), including qualifying longevity annuity contracts ("QLACs"), that were purchased before the SECURE Act changed the law.

In general, a DIA is a deferred annuity contract that provides only for annuity payments commencing on a specified future date, with no cash benefits prior to that date. A QLAC is a type of DIA that satisfies certain requirements in the RMD regulations.[33] DIAs and QLACs will qualify for grandfathering treatment under the SECURE Act even if the annuity payments are scheduled to start on or after December 20, 2019, provided that, before such date, the owner made the irrevocable election described above. In that regard, DIAs and QLACs often provide the owner with the following rights that, if elected, can affect the future annuity payments:

- *Additional premiums* – DIAs and QLACs often allow for additional premiums to be paid after they are purchased. Such additional premiums increase the dollar amount of the annuity payments that are scheduled to start in the future. In other words, each additional premium purchases an additional "paid up" annuity benefit that is determined under the terms of the contract as originally issued, and the additional amount will be paid under the same terms as the original annuity benefits, starting on the same date and lasting for the same duration.

- *Start date flexibility* – Some DIAs and QLACs provide a limited right to change the annuity starting date, *e.g.*, to accelerate it up to five years or defer it up to five years (subject to the requirements in the RMD regulations). For example, if a DIA provides for annuity payments to start on January 1, 2030, the contract may provide the owner with a one-time election to start the annuity payments as early as January 1, 2025, or as late as January 1, 2035. If the owner makes this election, the dollar amount of the annuity payments is adjusted up or down to reflect the different start date, with such adjustment being made pursuant to the terms of the contract as originally issued.

Because these product features can affect the amount and timing of the annuity payments thereunder, they present a question whether, and if so to what extent, they affect the availability of the SECURE Act's grandfathering rule. Guidance is needed to clarify how the grandfathering rule applies in these circumstances.

Guidance request: The Committee requests guidance clarifying the extent, if any, to which the payment of a premium on or after December 20, 2019, into a DIA or QLAC that is otherwise a "qualified annuity" under section 401(b)(4) of the SECURE Act causes the contract to fail to be treated as a "qualified annuity." The Committee also requests guidance to clarify that a DIA or QLAC that allows the individual to accelerate or defer the starting date of the annuity payments by up to five years, and is otherwise a "qualified annuity" under section

[32] Section 401(b)(4)(B)(iii) of the SECURE Act.

[33] *See* Treas. Reg. section 1.401(a)(9)-6, Q&A-17.

401(b)(4) of the SECURE Act, will not cause the contract to fail to be treated as a "qualified annuity."

III. Longstanding RMD Barriers to Life Annuities

Certain aspects of the current RMD regulations discourage and, in some cases, effectively prohibit individuals from receiving their retirement benefits as a life annuity. This problem has persisted for years and guidance continues to be needed on three aspects of the current regulations that are at the core of the problem. The three issues on which the Committee requests guidance to remove these barriers to life annuities are summarized below. Attached as Exhibit B is a memorandum further discussing these issues and our recommended guidance.

A. Minimum Income Threshold Test – *HIGH PRIORITY*

Background and problem: Treas. Reg. section 1.401(a)(9), Q&A-14(c), requires commercial annuities to pass a minimum income threshold test (MITT) if they provide certain types of benefits that the regulations characterize as "increasing." The MITT requires the use of a life expectancy table that has become outdated and that does not comport with industry practices in pricing life annuity payouts, particularly for single life annuities. This, combined with a historically prolonged period of low interest rates, has caused traditional and common forms of life annuities, such as a level-pay life annuity with a refund benefit, to fail the MITT in irrational circumstances, rendering these annuities unavailable to many retirees seeking lifetime income. These problems have persisted for over 10 years with no relief.

Guidance requests: The Committee requests that the RMD regulations be amended as soon as possible to:

(1) Permit the use of the Uniform Lifetime Table ("ULT") of Treas. Reg. section 1.409(a)(9)-9 when applying the MITT to single life and joint life annuities, instead of requiring the use of single life and joint life tables, respectively, of that regulation; and

(2) Apply to commercial annuities the same 5% cap on annual payment increases that applies to defined benefit plans pursuant to Treas. Reg. section 1.401(a)(9)-6, Q&A-14(d)(1).

B. Qualifying Longevity Annuity Contracts – *MEDIUM PRIORITY*

Background and problem: Treas. Reg. section 1.401(a)(9)-6, Q&A-17, prescribes rules for qualifying longevity annuity contracts (QLACs). Such contracts generally are subject to the MITT. In addition, they are subject to contribution limits that differ between qualified plans and IRAs and to death benefit rules that differ between spouse and non-spouse beneficiaries.

Guidance request: Guidance is needed to: (a) clarify how the MITT applies to QLACs in light of their unique characteristics that were not contemplated when the MITT was created, (b) clarify the contribution limits when a QLAC is purchased *via* rollover from a qualified plan to an IRA, and (c) clarify the QLAC rules governing spousal death benefits in the event of divorce.

C. Timing of Annuity Payments – *MEDIUM PRIORITY*

Background and problem: It is important that retirees have the flexibility to receive short-term advances of some of their future annuity payments, such as an advance of three months' payments with monthly payments resuming thereafter. This flexibility encourages annuitization by addressing prospective policyholders' concerns over lost liquidity. It is not clear whether such short-term accelerations are permitted by the rules under Treas. Reg. section 1.401(a)(9)-6 limiting "increasing" payments (Q&A-14(c)(4) and (e)(4)) and requiring the interval between payments to be "uniform" (Q&A-1(a)).

Guidance request: The Committee requests guidance clarifying that that a short-term advancement of annuity payments is not subject to the limitations on increasing annuity payments and will not result in a change in the interval between annuity payments.

* * * * *

We appreciate your consideration of our request for guidance on these issues. If you have any questions or if we can be of any assistance, please contact either of the undersigned by phone at 202-347-2230 or by e-mail at the addresses indicated below.

Sincerely,

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www.annuity-insurers.org

Attachments: Exhibit A (list of member companies)
Exhibit B (memorandum on RMD barriers to life annuities)

Exhibit A

THE Committee OF Annuity Insurers
www.annuity-insurers.org

AIG Life & Retirement, Los Angeles, CA
Allianz Life Insurance Company, Minneapolis, MN
Allstate Financial, Northbrook, IL
Ameriprise Financial, Minneapolis, MN
Athene USA, Des Moines, IA
Brighthouse Financial, Inc., Charlotte, NC
Equitable, New York, NY
Fidelity Investments Life Insurance Company, Boston, MA
Genworth Financial, Richmond, VA
Global Atlantic Financial Group, Southborough, MA
Great American Life Insurance Co., Cincinnati, OH
Guardian Insurance & Annuity Co., Inc., New York, NY
Jackson National Life Insurance Company, Lansing, MI
John Hancock Life Insurance Company, Boston, MA
Lincoln Financial Group, Fort Wayne, IN
Massachusetts Mutual Life Insurance Company, Springfield, MA
Metropolitan Life Insurance Company, New York, NY
National Life Group®, Montpelier, VT
Nationwide Life Insurance Companies, Columbus, OH
New York Life Insurance Company, New York, NY
Northwestern Mutual Life Insurance Company, Milwaukee, WI
Ohio National Financial Services, Cincinnati, OH
Pacific Life Insurance Company, Newport Beach, CA
Protective Life Insurance Company, Birmingham, AL
Prudential Insurance Company of America, Newark, NJ
Sammons Financial Group, Chicago, IL
Security Benefit Life Insurance Company, Topeka, KS
Symetra Financial, Bellevue, WA
Talcott Resolution, Windsor, CT
TIAA, New York, NY
The Transamerica companies, Cedar Rapids, IA
USAA Life Insurance Company, San Antonio, TX

The Committee of Annuity Insurers was formed in 1981 to participate in the development of federal policies with respect to annuities. The member companies of the Committee represent more than 80% of the annuity business in the United States.

GUIDANCE NEEDED ON THE TREATMENT OF ANNUITY PAYMENTS UNDER THE SECTION 401(a)(9) REQUIRED MINIMUM DISTRIBUTION REGULATIONS

The Treasury Department has focused significant effort in recent years on the important goal of encouraging greater availability and use of lifetime income options in defined contribution ("DC") plans and IRAs. These efforts have included amendments to the required minimum distribution ("RMD") regulations under section 401(a)(9) to facilitate qualifying longevity annuity contracts ("QLACs") and other helpful guidance regarding life annuities.[1] Nevertheless, certain provisions of the RMD regulations continue to discourage, and in some cases prevent, individuals from receiving common forms of life annuity benefits from DC plans and IRAs.

The Treasury Department's laudable goals on lifetime income can be further advanced by eliminating these remaining barriers to life annuities under the RMD regulations. There are three issues in particular, all arising under the Q&As in Treas. Reg. section 1.401(a)(9)-6, that need to be addressed:

- <u>The Minimum Income Threshold Test ("MITT")</u>: Q&A-14 limits the use of an annuity that provides payments the regulations characterize as "increasing." This provision is meant to preclude inappropriate tax deferral by limiting the ability to backload annuity payments. In practice, however, it is precluding common forms of life annuities in circumstances that do not advance the intended policy goal and instead detract from the broader goal of facilitating access to lifetime income.

- <u>Qualifying Longevity Annuity Contracts</u>: Q&A-17 provides important and very helpful guidance on QLACs, but there are several provisions that create uncertainty and thus discourage the use of QLACs in some situations.

- <u>Annuity Payment Interval</u>: Q&A-1(a) addresses the required interval between annuity payments. This provision suggests that certain types of short-term annuity payment advances are not allowed, such as an advance of three months' payments with monthly payments resuming thereafter. This unnecessarily limits liquidity in a way that discourages the election of a life annuity.

The remainder of this memorandum discusses these issues and the Committee of Annuity Insurers' proposals for addressing them.

(1) <u>Minimum Income Threshold Test</u>

(a) <u>Background</u>

The regulations under section 401(a)(9) require annuity payments to be non-increasing, subject to certain exceptions.[2] Other than in the case of certain cost of living adjustments, any

[1] Unless otherwise indicated, our references to "section" or "sections" mean sections of the Internal Revenue Code of 1986, as amended.

[2] Treas. Reg. section 1.401(a)(9)-6, Q&A-14(a).

form of increasing payment under a commercial annuity must satisfy the MITT.[3] For example, the MITT applies to commercial annuity contracts that (i) provide for annuity payments that increase by a constant percentage each year (*e.g.*, 3%), (ii) provide for annuity payments that may increase due to dividends (*i.e.*, participating annuities), (iii) provide an acceleration option such as a partial or full commutation, and (iv) provide a cash refund payable on the annuitant's death (collectively, "increasing benefits").[4]

The preamble to the final regulations explains that the MITT is designed to ensure "that annuity payments start at a high enough amount to prevent inappropriate deferral."[5] To this end, the MITT requires that the "total future expected payments" must exceed the total value being annuitized.[6] For these purposes the total future expected payments are calculated based on the Single Life Table (SLT) in the regulations (or the Joint and Last Survivor Table (JLT) in the case of a joint and last survivor annuity), without regard to any increases in annuity payments after the first payment and taking into account any period certain.[7]

(b) Problems under the MITT

The MITT has been problematic since it was adopted because of its breadth, mechanics, and consequences on the use of life annuities that provide increasing benefits. It reflects a tilt in the regulations that favors non-annuitized accounts over life annuities. Specifically, RMDs from a non-annuitized account are determined using the ULT, which is a joint and survivor table that assumes the participant has named a beneficiary who is 10 years younger. This joint life table is used to determine RMDs from non-annuitized accounts even if the participant has not named a beneficiary.[8] Thus, all individual account owners get the benefit of a joint life assumption.

In contrast, if a participant elects a single life annuity with one of the common benefits referenced above, the MITT requires a single life assumption based on the SLT to be used in determining the "total expected future payments" under the annuity. Using the SLT rather than the ULT reduces the "total future expected payments," thereby making it more difficult to pass the MITT than if the ULT were used, as it is for individual accounts even where there is no beneficiary. As a result, the MITT has for years prevented traditional forms of increasing benefits from being used in a variety of arbitrary circumstances where it is likely that all would agree there is no "inappropriate tax deferral."

The problem has gotten far worse in recent years, however. Mortality improvements since the MITT was created, combined with a prolonged period of historically low interest rates, have had the effect of reducing the dollar amount of a life annuity benefit that can be provided

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3 Treas. Reg. section 1.401(a)(9)-6, Q&A-14(c).

4 *Id*.

5 Required Distributions from Retirement Plans, 69 Fed. Reg. 33,288, at 33,291 (June 15, 2004) (preamble to final regulations).

6 Treas. Reg. section 1.401(a)(9)-6, Q&A-14(c), (e)(1), and (e)(3).

7 Treas. Reg. section 1.401(a)(9)-6, Q&A-14(e)(3). The Single Life Table is found in A-1 of Treas. Reg. section 1.401(a)(9)-9 and the Joint and Last Survivor Table is found in A-3 of the same regulation.

8 Treas. Reg. section 1.401(a)(9)-5, Q&A-4.

under a commercial annuity for any given amount of premium. Lower interest rates reduce the amount of an annuity payment purchased by a given premium (all other things being equal) because the insurer has lower earnings on the premium to fund the future annuity payments. Similarly, increased longevity means that the number of future payments the insurer will make for a given premium will be greater, which means the dollar amount of each payment will be less (all other things being equal). In short, the total dollar amount of payments an individual will receive for a given premium today are considerably less than an individual of the same age and sex who purchased the same annuity 15 years ago would have received.

For a life annuity to pass the MITT, the "total future expected payments" must exceed the total value being annuitized (generally the premium for the annuity). Because the regulations require the "total expected future payments" to be determined not by summing the expected number of payments that will be made as determined by the insurer based on current mortality expectations, but rather by summing the expected number using the outdated life expectancy tables in the regulations, the dollar amount of the "total future expected payments" will always be smaller than those the insurer has assumed for the premium paid. Thus, we have a circumstance where changing financial conditions and increased longevity combined with the artificial and increasingly erroneous SLT limitation of the MITT have greatly depressed one side of the equation – total expected future payments – while holding constant the other side – the actual premium paid. This, of course, has resulted in an ever smaller excess of the total expected future payments over the premium paid, making it increasingly difficult for a life annuity contract with common forms of increasing benefits to comply with the MITT.

As a result, traditional forms of life annuities are often unavailable to DC plan participants and IRA owners because they would violate the RMD rules. The following are examples from recent experiences of the Committee's member companies:

- A company found that a level-payment life annuity with a lump sum return of premium death benefit fails the MITT if issued to a 72-year-old but not if issued at other ages.

- A company found that an individual age 70 cannot purchase a life annuity with a 3% annual increase and a lump sum return of premium at death.

- A company determined that annual percentage increases would need to be less than 2% in order for its life annuities to pass the MITT. The company concluded that increases that small are not marketable as an effective hedge against inflation,[9] so the company currently does not offer any annual percentage increases under its annuities at all.

- Companies generally find that life annuities with lump sum return of premium death benefits fail the MITT more often than life annuities with period certain features, despite the fact that the former distribute benefits more rapidly than the latter.

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[9] *See* BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, CPI DETAILED REPORT: DATA FOR JUNE 2017, at 72-75 tbl.24 (Malik Crawford et al. eds., 2017), *available at* https://www.bls.gov/cpi/tables/detailed-reports/home.htm (showing inflation rates generally exceeding 2% per year).

(c) Update the MITT

In view of the problems described above, the Committee requests that the MITT be updated to:

(1) Permit the use of the ULT when applying the MITT to single life and joint life annuities, instead of requiring the use of the SLT and JLT, respectively,[10] and

(2) Apply the same 5% cap on annual payment increases under commercial annuities that applies to defined benefit plans.

This approach would eliminate a real and significant barrier to life annuities while continuing to impose appropriate limits on back-loaded payouts. For example, using the ULT when applying the MITT would provide needed relief for the four types of annuity benefits described above, without the need to specifically exempt those benefits from the test.

Allowing the ULT to be used in the MITT also would eliminate the disparity in the regulations that favors non-annuitized accounts over life annuities. The regulations currently allow the ULT to be used to determine RMDs from non-annuitized accounts even if the participant has not named a beneficiary, while the MITT requires a single life assumption based on the SLT. This disparity itself discourages the election of life annuities because it allows for smaller distributions – and thus lower tax burdens – from individual accounts than life annuities. A tax disincentive to electing a life annuity is particularly inappropriate given that individuals already are often reluctant to elect a life annuity despite the substantial benefits of doing so.

Research suggests that the reasons for this reluctance include (1) a behavioral response to the risk-pooling nature of insurance, *i.e.*, the fear of financially "losing" if early death prevents the payment of at least a significant amount of cash benefits under the contract, and (2) a perceived loss of "control" over one's savings, because converting a lump sum into a series of life annuity payments often involves a corresponding reduction in liquidity with respect to the annuitized sum.[11] Not only do the RMD rules add a tax disincentive to these behavioral barriers to life annuities, the MITT also has been precluding the availability of life annuity options that are expressly designed to address those behavioral barriers, namely, return of premium death benefits and acceleration rights.

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[10] Use of the ULT in the MITT should be optional and not mandatory. For example, in the case of a joint and survivor annuity, taxpayers should continue to be allowed to use the JLT when applying the MITT to their contracts. This would be desirable, for example, if the joint annuitant was a spouse who is 10 years younger than the participant.

[11] *See*, *e.g.*, Jeffrey R. Brown, *Rational and Behavioral Perspectives on the Role of Annuities in Retirement Planning* (Nat'l Bureau of Econ. Research, Working Paper No. 13537 October 2007), *available at* http://www.nber.org/papers/w13537 (discussing (1) complexity and financial literacy, (2) "mental accounting" and "loss aversion," (3) "regret aversion," and (4) the "illusion of control" as behavioral factors that may contribute to a reluctance to annuitize); Wei-Yin Hu and Jason S. Scott, *Behavioral Obstacles to the Annuity Market* (Soc. Sci. Research Network, Working Paper March 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=978246 (similar).

Based on the foregoing, we urge the Treasury Department to update the MITT to allow the use of the ULT in the manner described above. Doing so would create parity between the treatment of individuals who elect life annuities and those who do not,[12] while also eliminating the current-law barriers to life annuities. Allowing the use of ULT in this manner would also reaffirm the Treasury Department's commitment to encouraging lifetime income elections.

(d) Update mortality tables for the MITT

The current life expectancy tables in the RMD regulations (the SLT, JLT, and ULT) were derived from the basic 2000 individual annuity mortality table, projecting mortality improvements through 2003.[13] The regulations authorize the Service to update the tables, but they have not been updated.[14] Pursuant to Executive Order 13847, *Strengthening Retirement Security in America,*[15] the Treasury Department and IRS published a Notice of Proposed Rulemaking on November 8, 2019, to update the RMD tables.[16] We recommend the following approach:

- Initial update. The first update should be based on the 2012 Individual Annuity Reserving Table and its corresponding mortality improvement projection factors through the date of the update (the "2012 IAR Table"). This table, which is published by the Society of Actuaries ("SOA"), is currently the prescribed table for standard valuation and statutory reserve purposes under state law for individual annuities. The table is among three published by the SOA and, because it is used principally in determining required reserves for life insurance companies, it reflects the longest life expectancies of the three SOA tables. Thus, using this table would allow plan participants and IRA owners to "keep more money in 401(k)s and Individual Retirement Accounts for longer" and to "spread retirement savings over a longer period of time," which are two of President Trump's goals in issuing Executive Order 13847.

- Future updates. With the goal of striking a balance between the need to provide RMD mortality tables that reflect current life expectancies and the desire to minimize the administrative burden of implementing new RMD mortality tables, the Committee respectfully requests that final regulations provide that the RMD mortality tables will be updated through guidance published at regular specified intervals. In this regard, the

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[12] This disparity between accounts and annuities has been recognized by Senators Portman (R-OH) and Cardin (D-MD), who on October 15, 2018, released a discussion draft of legislation that would help establish parity between such forms of benefit. Specifically, in recognition of "the fact that in the vast majority of cases, annuity payments are in excess of the amounts that would have been required under the individual account rules," the proposal would direct the Treasury Department to amend the RMD regulations to allow any such excess to reduce the RMD obligation with respect to any portion of an individual's benefit that remains in a non-annuitized account. On May 13, 2019, Senators Portman and Cardin introduced S. 1431, the Retirement Security and Savings Act of 2019, which contains the identical provision (§ 203).

[13] *See* Required Distributions From Retirement Plans, 67 Fed. Reg. 18988, 18989 (April 17, 2002) (preamble to final and temporary regulations).

[14] Treas. Reg. section 1.409(a)(9)-9, Q&A-4.

[15] 83 Fed. Reg. 45,321 (Sept. 6, 2018).

[16] 84 Fed. Reg. 60812 (November 8, 2019).

Committee feels that it would be sufficient if the RMD mortality tables are updated every 10 years.[17] The Committee does not believe it is necessary for such tables to be updated more frequently. The Committee also requests final regulations provide an approach for applying reasonable mortality improvements that plan administrators and IRA trustees, custodians, and issuers will be permitted to use in the event that RMD mortality tables are not updated within a period specified in final regulations.

(2) <u>Qualifying Longevity Annuity Contracts (QLACs)</u>

For the reasons discussed below, the Committee requests that the 2020-2021 Priority Guidance Plan also include guidance on the following three issues, each of which discourages and impedes the use of QLACs to provide life annuities to plan participants and IRA owners.

(a) <u>Clarify how the MITT applies to QLACs and DIAs</u>

Annuity payments under QLACs and similar annuity products known as deferred income annuities ("DIAs") generally must satisfy the MITT.[18] For example, QLACs and DIAs typically provide lump sum return of premium death benefits, which the RMD regulations treat as "increasing" payments that are not allowed unless the MITT is satisfied. As discussed above, the MITT requires the total future expected payments to exceed the total value being annuitized. There is considerable uncertainty regarding how the total value being annuitized should be determined for a QLAC or DIA.

The regulations provide that in the case of a deferred annuity purchased by a section 401(a) trust the "total value being annuitized" equals the value of the employee's "entire interest" being annuitized, valued as of the date annuity payments commence.[19] This definition, which seems to contemplate a deferred annuity with a cash value that is determinable at the annuity commencement date, does not fit well with QLACs or DIAs because (1) they do not have cash values, and (2) premiums are paid years in advance of the annuity commencement date. Thus, for QLACs and DIAs it may be necessary to deem an amount to be the "total value being annuitized" as of the annuity commencement date.

The regulations do not address this, but one possibility is that the total value being annuitized as of the annuity commencement date of a QLAC or other DIA is the present value of the future annuity payments. If that is the case, unexpected results could arise for such contracts under the MITT. For example, payments that were thought to comply as of a QLAC's issue date could unexpectedly fail the test on the annuity commencement date merely because of a change in interest rates after the contract was issued.

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[17] S. 1431, *supra* note 12, section 109, endorses a similar approach, which requires the Treasury Department to update the life expectancy tables in the RMD regulations every 10 years.

[18] A DIA generally is a deferred annuity contract that provides annuity payments commencing on a specified future date, provides no cash surrender value, and often provides a return of premium death benefit.

[19] Treas. Reg. section 1.401(a)(9)-6, Q&A-14(e)(1)(i). Similarly, the regulations provide that "[i]n the case of a defined contribution plan, the [total value being annuitized equals the] value of the employee's account balance used to purchase an immediate annuity under the contract." Treas. Reg. section 1.401(a)(9)-6, Q&A-14(e)(1)(iii).

To illustrate, if interest rates are lower on the annuity commencement date than they were on a QLAC's issue date, and such lower rates were used on the annuity commencement date to calculate the present value of future payments, the resulting present value would be higher than the one the issuer expected would arise based on the interest rate used in establishing the benefit levels under the QLAC when the contract was issued. In that circumstance, the deemed "total value being annuitized" could be greater than the "total future expected payments," thereby failing the MITT, even though the issuer designed the contract to comply with the test when the contract was issued, and even though the "failure" resulted solely from a later change in interest rates causing a different interest rate assumption to be used in the present value calculation.

All this creates uncertainty regarding how the RMD rules apply to QLACs and DIAs and under what circumstances an insurer can confidently issue a compliant contract. Such uncertainty will dissuade insurance companies from issuing these contracts in the retirement context or increase the costs of issuing such contracts, which will be passed on to retirees. These uncertainties could be eliminated if the rules were amended to allow the total value being annuitized to be determined at the time of the contract's issue date or as of the last premium payment made for the contract.

(b) Clarify the QLAC premium limits to facilitate purchases *via* rollovers to IRAs

QLACs are readily available in the IRA market, but it is rare for a qualified plan to offer a QLAC option directly. As a result, the only way for virtually any participant in a qualified plan to obtain a QLAC is by rolling money out of the plan to an IRA. However, there is considerable uncertainty regarding how the limits on QLAC premiums in the regulations apply when an amount is rolled from a qualified plan to an IRA in order to obtain a QLAC. This uncertainty is having a significantly adverse effect on the availability of QLACs in the marketplace.

In that regard, the regulations limit the premiums that an individual can pay for a QLAC to the lesser of $125,000 or 25% of the account balance under the plan or IRA.[20] The $125,000 limit applies across all types of arrangements, whereas the 25% limit applies separately to each qualified plan in which the individual participates and collectively to all IRAs that an individual owns.[21] For purposes of the 25% limit, the account balance of a qualified plan is determined as of the most recent valuation date and is adjusted up or down to reflect subsequent contributions or distributions, respectively.[22] In contrast, the account balance of an IRA is determined as of December 31st of the previous calendar year, and there is no specific mention of any adjustment for subsequent contributions or distributions.[23]

When a QLAC is purchased in a direct rollover from a qualified plan to an IRA, it is not clear which account balance should be used when applying the 25% limit. In other words, it is not clear whether the regulations limit the purchase to 25% of the individual's account balance in

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[20] Treas. Reg. section 1.401(a)(9)-6, Q&A-17(a)(1) and (b). The limit was adjusted for inflation to $135,000, effective January 1, 2020. Notice 2019-59, 2019-47 I.R.B. 1091.

[21] Treas. Reg. section 1.401(a)(9)-6, Q&A-17(b); Treas. Reg. section 1.408-8, Q&A-12(b)(3).

[22] Treas. Reg. section 1.401(a)(9)-6, Q&A-17(d)(1)(iii).

[23] Treas. Reg. section 1.408-8, Q&A-12(b)(3)(i).

the plan or 25% of the account balance in the individual's IRAs. If the limit applies based on the IRA account balance, the QLAC purchase could be unnecessarily complicated and delayed. Moreover, in many cases the individual would need to quadruple the amount of the rollover just to facilitate the QLAC purchase. These problems are illustrated in the following example:

> Assume that an individual has a $500,000 account balance in her former employer's qualified plan. She wants to use 10% of that balance, or $50,000, to purchase a QLAC, but her plan does not offer one. She decides to roll the money from the plan to purchase a QLAC that also qualifies as an IRA annuity. However, she currently does not own any IRAs. If the 25% limit on QLAC premiums applies based on her IRA account balance (which is zero), she will need to roll $200,000 from her plan just to facilitate the $50,000 QLAC purchase. Moreover, because the regulations measure her IRA account balance as of the prior year-end (which, again, was zero), she will need to roll the $200,000 from the plan to an IRA, wait until the next year, then transfer $50,000 from the IRA to a QLAC that qualifies as an IRA annuity. After the transaction, the individual would own a QLAC that clearly complies with the intent of the premium limits, but would have unnecessarily moved $150,000 from her plan to an IRA and would have suffered a considerable delay and possibly additional expense in obtaining the QLAC.

The market is generally interpreting the regulation conservatively and is applying the cumbersome approach described in the example above. This, in turn, is having a significantly adverse effect on the ability of individuals to protect themselves against longevity risk through the purchase of a QLAC. The solution to this problem would be for the IRS to issue guidance clarifying that the 25% limit applies based on the account balance in the plan in the following circumstances.

- The guidance could describe a situation like the one in the example above, involving a direct rollover from a plan to an IRA for the specific purpose of purchasing a QLAC.

- The guidance would then clarify that in such a situation the 25% limit is applied based on the account balance in the plan as of the most recent valuation date occurring immediately before the rollover, not the prior year-end account balance in the IRA.

- This would merely clarify which of two existing rules in the regulations applies to the transaction. Moreover, in the direct rollover context where the distribution is used to directly purchase a QLAC, treating the distribution as coming from the plan for purposes of the 25% limit is entirely consistent with the structure of the section 401(a)(9) regulations, which state that in the context of a rollover, "the amount distributed is still treated as a distribution by the distributing plan for purposes of section 401(a)(9), notwithstanding the rollover."[24]

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[24] Treas. Reg. section 1.401(a)(9)-7, Q&A-1.

- Thus, the regulations would not need to be amended. In addition, the transaction would be reported on existing forms without the need for the IRS to amend those forms.[25]

(c) Clarify QLAC spousal death benefits in the event of divorce

The QLAC regulations prescribe very different rules depending upon whether the owner's beneficiary is his or her spouse. If a QLAC owner's sole beneficiary is his or her spouse, the contract can provide *both* a lump sum return of premium death benefit *and* a 100 percent survivor annuity.[26] However, if the owner's sole beneficiary under a QLAC is not his or her spouse, the contract can provide *either* a lump sum return of premium death benefit *or* a survivor annuity (but not both), and a non-spouse survivor annuity is subject to a required reduction in the annuity payments after the owner's death.[27]

The regulations do not address how these death benefit rules apply if the beneficiary is the owner's spouse when the contract is issued, but because of a subsequent divorce is no longer the owner's spouse when annuity payments commence or when the owner dies.[28] If a beneficiary's status as a spouse or non-spouse is determined after a QLAC is issued, *e.g.*, on the date annuity payments commence, a contract that was issued with permissible benefits might be viewed as providing impermissible benefits merely because of the divorce.

If a contract that is intended to be a QLAC provides impermissible benefits, the value of the contract must be included in the account balance used to determine the owner's required minimum distributions. To prevent this potential adverse and unintended result, in theory the issuer could modify the contract's benefits after the divorce, but this may be difficult or impossible. The price and benefits can differ materially based on whether the spouse or non-spouse rules apply, and insurers need to know which rules will apply so they can price the product at issuance and so the purchaser will know what they are getting for what price. If a contract failed to be a QLAC following the divorce, the owner could become liable for a 50% excise tax under section 4974. The mere possibility that this problem can arise in the event of a divorce after a QLAC is purchased may prevent a QLAC issuer from offering the maximum permissible death benefit to a spouse beneficiary.

The solution to this problem would be for the IRS to issue guidance clarifying that a divorce occurring after a QLAC is purchased but before payments commence will not affect the permissibility of the joint and survivor benefits previously purchased under the contract if a qualified domestic relations order ("QDRO") (in the case of a retirement plan) or a divorce or separation instrument (in the case of an IRA) provides that the former spouse is entitled to the promised spousal benefits under the QLAC. Such a clarification would be consistent with a

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[25] Specifically, the applicable IRS forms would be Form 1099-R (reporting the direct rollover), Form 5498 (reporting the contribution to the IRA annuity that qualifies as a QLAC), and Form 1098-Q (reporting the premiums and other information regarding the QLAC).

[26] Treas. Reg. section 1.401(a)(9)-6, Q&A-17(c)(1).

[27] Treas. Reg. section 1.401(a)(9)-6, Q&A-17(c)(2).

[28] *Compare* Treas. Reg. section 1.401(a)(9)-6, Q&A-2(b) (spousal status is determined "as of the annuity starting date for annuity payments") and Treas. Reg. section 1.401(a)(9)-5, Q&A-4(c)(2) (spousal status for individual accounts is re-determined on January 1st of each year).

general rule that already exists in the section 401(a)(9) regulations, which provides that a former spouse is treated as a spouse for purposes of the minimum distribution requirements if certain requirements are met. That rule states:

> A former spouse to whom all or a portion of the employee's benefit is payable pursuant to a QDRO will be treated as a spouse (including a surviving spouse) of the employee for purposes of section 401(a)(9), including the minimum distribution incidental benefit requirement, regardless of whether the QDRO specifically provides that the former spouse is treated as the spouse for purposes of sections 401(a)(11) and 417.[29]

It appears, though not clearly, that this general rule applies to QLACs, but in light of the repercussions of being wrong on this point, the market appears to have generally taken a conservative position on the application of the rule to QLACs, which makes selling QLACs in the plan context very difficult. Accordingly, it is very important that there is confirmation that the above quoted general rule applies to QLACs in the plan context.

In addition, although QDROs are a concept applicable to employer-sponsored plans and not IRAs, a parallel concept should apply to IRAs, but obviously without regard to the technical requirements that apply to QDROs. Applying a parallel concept to IRAs is supported by the existing regulatory provision that, except as otherwise provided, all of the section 401(a)(9) rules for plans apply to IRAs.[30] As a result, clarification that such a parallel concept regarding former spouses applies for purposes of QLACs issued in the IRA market would be both appropriate and very helpful in addressing an uncertainty that has inhibited the QLAC/IRA market. Such a clarification could provide that "divorce or separation instruments"[31] can cause a former spouse to be treated as the spouse for minimum distribution purposes, including QLACs, in the same manner as a QDRO.

For IRAs, spousal rights may continue after a divorce in two distinct ways. First, a former spouse may have rights under the contract which remain pursuant to a divorce or separation instrument. Second, the former spouse may be contractually entitled to benefits originally purchased under the contract which remain unchanged after a divorce or separation. In the latter case, the parties may not think they need to specify in the divorce or separation agreement that the former spouse will continue to be the beneficiary of the QLAC upon the owner's death. For this reason, the guidance would have an even broader and more appropriate effect if it could also clarify that, even in the absence of a formal divorce or separation instrument that addresses the contract, a former spouse is treated as the spouse for purposes of the QLAC requirements as long as the former spouse remains contractually entitled to the benefits originally purchased under the contract following the divorce.

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[29] Treas. Reg. section 1.401(a)(9)-8, Q&A-6(a).

[30] *See* Treas. Reg. section 1.408-8, Q&A-1

[31] This term would have the meaning set forth in section 71(b)(2).

These clarifications would ensure that former spouses can be protected both in plans and IRAs. Moreover, because these clarifications are consistent with the existing regulations and would merely explain how those regulations apply to QLACs, the clarifications could be provided through IRS guidance without having to amend the regulations.

(3) <u>Flexibility on the timing of annuity RMD payments</u>

An IRA owner or employee is permitted to take his RMD for a calendar year with respect to an individual account at any time during the calendar year.[32] In addition, an individual is not required to take withdrawals from an individual account in uniform intervals during a year or from year to year. For example, an individual may withdraw an RMD in a single lump sum at the beginning of one calendar year, in a single lump sum at the end of another calendar year, and in installments throughout another calendar year. This flexibility is obviously helpful and desirable to some elderly individuals because they can accelerate some or all of their account-based RMDs for the year if they have an unexpected financial need during the year.

Annuity issuers would like to provide IRA owners and employees who annuitize part of their retirement savings with similar flexibility. Some commercial annuities already allow owners to accelerate, or advance, one or more annuity payments scheduled to be made within a specified period of time, *e.g.*, within a contract year. Although annuity payments can be accelerated in some cases under the RMD regulations, it appears that the acceleration must shorten the annuity period or reduce the amount of the payments to be made under the annuity.[33] A more limited form of acceleration, *e.g.*, the receipt in January of the monthly payments for February and March, would affect only the timing within a year of the payments, *i.e.*, neither the duration of the annuity period nor the sum of the payments that will be made under the annuity is reduced, and thus may run afoul of the regulations. In addition, the regulations can be read as precluding a change in the interval between annuity payments even though the change is only temporary and results only in an acceleration of payments.[34]

This matter can be easily addressed by modifying the RMD regulations to clarify that a short-term advancement of annuity payments is not subject to the limitations on increasing annuity payments and will not result in a change in the interval between annuity payments. Importantly, such a clarification would remove a restriction on the frequency of annuity payments which is completely unnecessary in these circumstances. It would also reduce the disparate treatment of individual accounts and annuities under the regulations.

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If any questions arise regarding this memorandum, please contact Bryan W. Keene or Mark E. Griffin of Davis & Harman LLP by phone at 202-347-2230 or by email at bwkeene@davis-harman.com or megriffin@davis-harman.com, respectively.

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[32] Treas. Reg. section 1.401(a)(9)-5, Q&A-1(c).

[33] Treas. Reg. section 1.401(a)(9)-6, Q&A-14(c)(4) and (e)(4).

[34] Treas. Reg. section 1.401(a)(9)-6, Q&A-1(a) ("The interval between payments for the annuity must be uniform over the entire distribution period and must not exceed one year.").