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Employee Benefit Plan Review

# Stretching Expectations: Planning with the New Life Expectancy Tables for Retirement Plans' Required Minimum Distributions

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For the first time in nearly 20 years, the Internal Revenue Service ("IRS") has updated its actuarial tables for determining required minimum distributions ("RMDs") from retirement plans. These new tables affect plan participants and Individual Retirement Account ("IRA") owners, "Eligible Designated Beneficiaries" and more. All individuals in pay status and their advisors should review the new tables to ensure that the proper RMD is paid from retirement accounts for 2022 and beyond.

## Required Minimum Distributions Explained

Under an IRA or defined contribution plan, such as a 401k, you must start taking annual withdrawals when you reach age 72 (or 70 1/2 if you reached that age before January 1, 2020). The Internal Revenue Service ("IRS") mandates the minimum amount of these annual withdrawals, commonly referred to as the RMD. The annual RMD is calculated using a formula that is equal to the account's value as of the beginning of the year divided by the "Applicable Divisor." This Applicable Divisor is determined by most plan participants using the "Uniform Lifetime Table." A plan participant whose sole beneficiary is his or her spouse may instead use the "Joint and Last Survivor Table" if the spouse is more than 10 years younger than the participant. Beneficiaries of inherited retirement plans determine their RMD using the "Single Life Table." These tables are published in the Treasury Regulations and can also be found in IRS Publication 590-B.

## How Your RMD Might Change

A 75-year-old IRA owner who applied the Uniform Lifetime Table under formerly applicable Section 1.401(a)(9)-9 to calculate her RMDs used a life expectancy of 22.9 years. However, applying the updated Uniform Lifetime Table, the same 75-year-old would use a life expectancy of 24.6 years. Assume that this same IRA owner had an IRA with an account balance of $1 million at the beginning of 2022. Under the old table, this $1 million account balance would be divided by the 22.9 years to get an RMD for 2022 of approximately $43,668; under the new tables, however, this same account would be divided by 24.6, resulting in a lower RMD of approximately $40,650, leaving $3,018 to grow tax-deferred in the retirement plan.

### Tables and Calculations for Beneficiaries

The surviving spouse of an account owner who is the sole IRA or plan beneficiary will use the new Single Life Table and will continue to recalculate his or her life expectancy annually based upon the new table.

A beneficiary of an account owner who died in 2020 or later who is a minor child, chronically ill or disabled (an Eligible Designated Beneficiary) and beneficiaries of account owners who died prior to 2020 will also be able to take advantage of the new tables. The distribution period for these beneficiaries is determined by finding the life expectancy on the Single Life Table based upon the beneficiary's age in the year following the year of the account owner's death. For each subsequent year, the RMD is calculated by taking that life expectancy number and subtracting one. For example, assume that a grandfather died in 2018, leaving his IRA to his granddaughter, who turned 40 in 2019. Under the old tables, the granddaughter would have used an Applicable Divisor of 43.6, which would then be reduced by one to calculate the RMD for each year after 2019.

Using the new tables, in 2022 the granddaughter will need to go back and determine the new life expectancy for a 40-year-old, which is now 45.7 years, and reduce it by one for each year that has elapsed since 2019. Applying this method, the granddaughter's Applicable Divisor, which would have been 40.6 in 2022 under the old table, is now 42.7. For a $1 million inherited IRA, the granddaughter would have a 2022 RMD of only $23,419 under the new tables, compared with $24,631 under the old tables.

Most beneficiaries of deceased account owners who died in 2020 or later will not be affected by the new tables, as the SECURE Act limited the payout period for people who are not Eligible Designated Beneficiaries to no more than 10 years. Similarly, if there is no Designated Beneficiary, and the IRA owner died prior to his Required Beginning Date, the five-year rule may apply, requiring distribution over that period instead of using the LIFE expectancy tables.

### Why This Change Matters

The new tables apply for RMDs in 2022 and future calendar years, even if the owner started taking RMDs in prior years. The longer life expectancies in the new tables mean longer distribution periods and smaller RMDs each year. The owner will, therefore, be able to further stretch the distribution of the retirement assets over his or her lifetime, deferring the income tax for a longer period and, potentially, leaving more assets in the plan for his or her beneficiaries upon his or her death.

Returning to the 75-year-old owner previously discussed, under the prior tables, she would have an annual RMD equal to 4.37 percent of her total retirement account, whereas under the new tables, she would have an annual RMD equal to only 4.07 percent of her account. The 0.30 percent net difference can be retained in the retirement account to grow free of income taxes. This comparison becomes even starker when looking at the RMDs for owners in their 80s and 90s. These lower RMDs may help keep owner's adjusted gross income ("AGI") low, reducing the possible effects of the net investment income or Medicare taxes, or the possibility of reaching the threshold or phase-outs for certain deductions and credits.

### What to Do Next

Although many people's annual retirement plan withdrawals may be based upon cash flow needs, for those who are able to limit their withdrawals to the minimum required by law it will be important to understand the new life expectancy tables in order to take advantage of their potential benefits. For IRA owners or plan participants with substantial retirement assets, or advisors looking to help clients plan for inherited retirement assets, contact an attorney to discuss appropriate strategies to maximize the use of retirement assets and the tax advantages associated with these assets.

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