Product Tax Update

SECURE Act, CARES Act, & Other Developments

2020 Insurance Tax Conference

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Overview

The SECURE Act	• Law changes, IRS guidance, and implementation
The CARES Act	• Relief, IRS guidance, and implementation
Other Developments	• New PLR addressing trust-owned annuities • IRS guidance on escheated retirement accounts • Withholding for periodic payments • New PLRs on investor control and pension contracts • What else may be coming?

Pub. L. No. 116-94

SETTING EVERY COMMUNITY UP FOR RETIREMENT ENHANCEMENT (SECURE) ACT

Changes to Required Beginning Date ("RBD")

SECURE Act

- Increases RBD to April 1 of the year following:
  - The year in which the individual reaches age 72, or
  - For plans, the year the individual retires (except for 5% or more owners)
- Effective for individuals who attain age 70½ in 2020 or later
  - Meaning those born <u>after</u> 6/30/49

Notice 2020-6

- Relief for IRA providers that mistakenly provide RMD notices to individuals attaining age 70½ this year
- Relief is conditioned upon the IRA issuer notifying the owner no later than April 15, 2020, that no RMD is required for 2020

Contributions to Traditional IRAs

SECURE Act

- Repeals the prohibition against contributions to Traditional IRAs after age 70 ½
- Does not change the requirement to have compensation (generally from work)
- But compensation now includes certain amounts received to aid pursuit of graduate or postdoctoral study

Notice 2020-6

- IRA issuers are not <u>required</u> to accept post-70 ½ contributions
  - If do, "must amend" endorsement
  - If amend in-force, must send updated IRA disclosure statement
- No netting post-70 ½ contributions with RMDs (separate transactions)

Qualified birth or adoption distributions (QBADs)

SECURE Act	Notice 2020-68 (highlights)

• QBADs permitted up to $5,000 from plan or IRA on an individual basis
• Exempt from 10% early distribution tax
• Exempt from 20% mandatory withholding, 402(f) notice, direct rollover requirements (if paid from plan)
• Repayment of distributions can be made <u>without set time limit</u>; no 60-day requirement
• Effective for distributions after 2019
	• Employer plans not <u>required</u> to allow
	• If plan allows QBADs and also permits rollover contributions, must permit repayment of QBADs too
	• Plan can rely on participant representations whether distribution is a QBAD
	• Guidance does not address how repayment affects:
	  • Participant’s taxes for that year, or
	  • One rollover per year limit for IRAs

“Stretch” RMDs

Prior Law	SECURE Act
• After-death RMD regulations permit a beneficiary to draw down the remaining plan or IRA benefits over the beneficiary’s life expectancy 	• Generally requires distributions within 10 years of death • Exception for spouse, disabled and chronically ill, beneficiary within 10 years of decedent, minors until age of majority • Generally applies to deaths in 2020 and later; does not apply to DB plans • Non-qualified annuities unaffected • More detail next slides …

“Stretch” RMDs – Key Provisions of Prior Law

Owner Dies Before RBD	Owner Dies On/After RBD
• Remaining interest must be distributed – • By the end of the calendar year containing the 5th anniversary of death (“5-year rule”), or • Over the life of the designated beneficiary, or over a period not extending beyond the designated beneficiary’s life expectancy, if distributions commence by the end of the year following the year of death (“stretch rule”)	• Remaining interest must be distributed at least as rapidly as under the method of distributions being made as of the date of death (the “at-least-as-rapidly rule”) • Death after annuitization treated as death on/after RBD regardless of age at death • This treatment facilitated the continuation of any period certain annuity payments after death

“Stretch” RMDs – Key Provisions of New Law

General Rules	Exception for EBDs
• New rules apply to any “designated beneficiary” (individual) of an owner if the owner dies after 2019 • Remaining interest must be distributed within 10 years of owner’s death • Regardless of when the owner dies in relation to their RBD or annuity starting date • If owner died before 2020 and beneficiary dies after 2019, 10-year rule applies after beneficiary’s death • Certain contracts grandfathered if irrevocably annuitized before 12/20/19 • Delayed effective date for some plans	• Eligible designated beneficiaries can “stretch” inherited benefit while alive • EDBs are (1) spouse, (2) minor child of owner, (3) disabled, (4) chronically ill, or (5) not more than 10 years younger than owner • EDB status is determined on date of owner’s death • 10-year rule applies when EDB dies and when minor child EDB reaches age of majority (18?)

"Stretch" RMDs – Key Provisions of New Law (continued)

Non-Individual Beneficiaries

- Includes estates, charities, and certain trusts that do not qualify for look-thru
- Prior law continues to apply
  - 5-year rule for death before RBD
  - At-least-as-rapidly rule for death on/after RBD

Special Rules for Certain Trusts

- New statutory rule for multi-bene trusts
  - A separate trust must be established for each beneficiary on death
  - Stretch rule can apply separately to chronically ill, disabled trust beneficiaries

"Stretch" RMDs – Payout Annuities

Applicable Rule	Implications for Payout Annuities
The 10-year rule applies to any non-EDB regardless of when the owner dies in relation to their RBD, *i.e.*, even if owner dies on/after their RBD	It appears that the at-least-as-rapidly rule no longer applies post-annuitization; period certain payments may need to be commuted/altered after death to comply with the 10-year rule
EDB status is determined as of the date of the owner's death, not at the annuity starting date	EDB status could change between annuity starting date and death (divorce?); joint life and period certain payouts may need to be commuted/ altered after death to comply with 10-year rule
Regulations continue to limit ability to accelerate annuity payments, *e.g.*, minimum income threshold test (MITT)	New rules may necessitate accelerations, but current regulations may make that difficult

SECURE Act – Practical issues

Annuity payout options – decisions needed on what to continue offering

- Limit to life with 10 years?
  - If not, can you ensure compliance with the MITT if a commutation is needed later?
- Limit to life with lump sum ROP and satisfy the MITT in all cases?
- Don’t allow joint life with minor as joint annuitant?
- Addressing other uncertainties, e.g., divorce after J&S payments start, grandfathering rule?

Amending IRA endorsements – new and in-force

- No “LRMs” yet – wait for them or amend now?
- IRS prototype approval process – status?
- Notice 2020-68: must amend IRAs for SECURE Act by 12/31/22
- State filing process – must factor in time for this too

SECURE Act – Practical issues (continued)

Trusts named as beneficiaries – how to handle pending guidance?

- Current regulations on "see-through" trusts:
  - No "separate accounting" for multiple trust beneficiaries
  - Rather, RMDs for all the trust beneficiaries are based on the oldest trust beneficiary
- Does this rule still apply? If so –
  - What if oldest trust beneficiary is an EDB and others are not?
    - All can "stretch" over EDB's life expectancy?
  - What if oldest trust beneficiary is not an EDB but others are?
    - None can stretch?

Pub. L. No. 116-136

Response to the Coronavirus Pandemic:

THE CORONAVIRUS AID, RELIEF, AND ECONOMIC SECURITY (CARES) ACT AND RELATED GUIDANCE

Coronavirus-Related Distributions & Notice 2020-50

- Up to $100,000 in the aggregate from all arrangements
- Available to 401(k), 403(b), 457(b), and IRAs (optional for plans)
- Exception to 10% additional tax
- Will not result in a modification of SEPPs taken to avoid the 10% additional tax
- Exempt from mandatory 20% withholding, 402(f) notice, and direct rollover rules that apply if from an eligible retirement plan
- Income inclusion over 3 years unless elect out
- If repaid within 3 years, treated as tax-free rollover
  - Must otherwise be eligible for rollover (not available for non-spouse beneficiary)
  - Will not violate 1-IRA-rollover-per-year rule
  - Plans not required to accept recontributions
  - Relief for accepting invalid recontributions

CRDs & Notice 2020-50 (continued)

- Eligibility criteria – A “qualified individual” who can take a CRD is an individual:
  - Who was diagnosed with SARS-CoV-2 or COVID-19 by a CDC-approved test,
  - Whose spouse or dependent is diagnosed with the virus or disease, or
  - Who experiences adverse financial consequences related to the disease as a result of:
    - Being quarantined
    - Being furloughed, laid off, or having work hours reduced
    - Being unable to work due to lack of child care
    - Closing a business or reducing business hours
    - Other factors determined by the IRS, e.g., member of household
- A plan administrator can rely on the individual’s certification that the individual meets the eligibility criteria

CRDs & Notice 2020-50 (continued)

- Tax Reporting
  - Qualified Individual – Must designate a CRD, and a recontribution, on:
    - Federal income tax return, and
    - Form 8915-E, Qualified 2020 Disaster Retirement Plan Distributions and Repayments
- Payor
  - CRDs must be reported on Form 1099-R, even if recontributed in the same year
  - If prior than age 59½, box 7 can identify either:
    - Distribution code 1 (early distribution, no known exception)
    - Distribution code 2 (early distribution, exception applies)

Plan Loan Relief

- Available to qualified individuals (same eligibility criteria as for CRD)
- Increases loan limit to $100,000 or 100% of account balance for loans made during 180-period after date of enactment (March 27, 2020)
- 1-year deadline extension for repayments due in 2020 after March 27
  - Interest continues to accrue
  - Repayment relief is optional
  - Safe harbor and other approaches provided in Notice 2020-50

RMD Waiver for 2020 & Notice 2020-51

- For defined contribution plans and IRAs
- Applies to:
  - RMDs for 2020
  - RMDs for 2019 due April 1, 2020, if not taken in 2019
  - Lifetime RMDs, as well as after-death RMDs
- Distributions taken as RMDs can be rolled over
  - Extension of 60-day rollover period to August 31, 2020
  - Waiver of the 1-IRA-rollover-per-year limitation if repaid *to same IRA*
  - Non-spouse beneficiaries permitted to repay if *to same IRA*
  - SEPPs that include RMDs can be rolled over
  - Plan relief from mandatory 20% withholding, 402(f) notice, and direct rollover requirements

RMD Waiver for 2020 & Notice 2020-51 (continued)

- For deaths occurring in 2019:
  - 1-year extension to end of 2021 of decision whether apply the stretch rule
  - 1 year added to 5-year period under 5-year rule (also for deaths before 2019)
- For deaths occurring in 2020:
  - No extension of 5-year & 10-year period under post-death RMD rules
- IRA amendments not necessary, but IRA owners must be informed
- Sample plan amendment provided; additional time allowed
- SEPPs must continue to avoid recapture of 10% additional tax

Other Relief Relating to COVID-19

- IRA contributions for the 2019 tax year can be made until July 15, 2020.
- Deadline for reporting the 10% additional tax (under Code section 72(q) or 72(t)) is postponed to July 15, 2020.
- The deadline for filing 2019 Form 5498 (and for providing copies to IRA owners) is postponed to August 31, 2020

PLR 202031008

NON-QUALIFIED ANNUITIES ISSUED TO TRUSTS

PLR 202031008

- Addresses how Code §§ 72(q) and 72(u) apply to a non-qualified deferred annuity that is issued to a trust in two different scenarios
- Grantor Trust Scenario:
  - Grantor is an individual
  - Primary annuitant under the contract is not the grantor
  - Trust has two beneficiaries – the primary annuitant and a charity
- Non-Grantor Trust Scenario:
  - Settlor is an individual
  - Primary annuitant under the contract is not the grantor
  - Trust has only one beneficiary – the primary annuitant

PLR 202031008 – Applicable Law

- Code § 72(q) – 10% penalty tax, with exceptions for distributions:
  - After "taxpayer" attains age 59 ½
  - On or after the death of the "holder"
  - Attributable to the "taxpayer's" becoming disabled
  - Substantially equal periodic payments for life/joint life of "taxpayer"
- Code § 72(u) – no tax deferral for contract "held by" non-natural person
  - But "holding by a trust or other entity as an agent for a natural person shall not be taken into account" when applying section 72(u)(1)
- Grantor vs. non-grantor trusts
  - Grantor trust – grantor taxed on trust property as if "the trust had not been in existence"
  - Non-grantor trust – trust-level tax but offsetting deductions for trust distributions

PLR 202031008 – Key conclusions

- Who is the taxpayer?
  - For a grantor trust, it's the grantor
  - For a non-grantor trust, it's the trust
  - Key implications:
    - For a grantor trust, the § 72(q) exceptions that refer to the "taxpayer" apply based on the grantor's age, disability, and life expectancy; other parties are ignored
    - For a non-grantor trust, none of those exceptions is available at all
- Who is the holder?
  - The trust, whether it's a grantor trust or a non-grantor trust
  - Key implications:
    - Death exception to § 72(q) applies based on the "primary annuitant" (for § 72(s) too?)
    - For § 72(u), look to grantor if grantor trust; otherwise look to the trust beneficiaries

PLR 202031008 – All conclusions summarized

Code Section	Conclusions Based on the Tax Status of the Trust	
	Grantor Trust	Non-Grantor Trust
72(q)(2)(A) 72(q)(2)(C) 72(q)(2)(D)	***Key conclusion:*** The individual grantor is the taxpayer by virtue of the general rules governing grantor trusts. ***Result:*** The exceptions to the 10% additional tax in section 72(q)(2)(A), (C), and (D) apply based on the individual grantor's age, disability, and life or life expectancy, respectively.	***Key conclusion:*** The trust is the taxpayer because the general rules for grantor trusts do not apply and a non-grantor trust technically must claim a deduction to avoid tax at the trust level, which makes the trust a taxpayer for federal income tax purposes. ***Result:*** The exceptions to the 10% additional tax in section 72(q)(2)(A), (C), and (D) are not available because a trust cannot attain age 59½, become disabled, or have a life or life expectancy.
72(q)(2)(B)	***Key conclusion:*** The trust is the holder because the trust is designated in the contract as the owner of the contract. ***Result:*** Because the trust is the holder and is not an individual, the parenthetical clause in section 72(q)(2)(B) controls, so that the exception to the 10% additional tax in that section applies upon the death of the primary annuitant. If the individual grantor differs from the primary annuitant, the exception will not apply upon the grantor's death.	***Key conclusion:*** The trust is the holder because the trust is designated in the contract as the owner of the contract. ***Result:*** Because the trust is the holder and is not an individual, the parenthetical clause in section 72(q)(2)(B) controls, so the exception to the 10% additional tax in that section applies upon the death of the primary annuitant.
72(u)(1)	***Key conclusion:*** The contract is held by the trust because the trust is designated in the contract as the owner of the contract. Due to the grantor trust rules, the trust is treated as holding the contract for the individual grantor. ***Result:*** The exception in section 72(u)(1) for contracts held by a trust or other entity as an agent for a natural person applies based on the grantor's status as an individual. It is irrelevant whether the beneficiaries named in the trust are individuals.	***Key conclusion:*** The contract is held by the trust because the trust is designated in the contract as the owner of the contract. The grantor trust rules do not apply, so the trust is not treated as holding the contract for the settlor/grantor. Rather, the trust is treated as holding the contract for the beneficiaries of the trust. ***Result:*** The beneficiaries of the trust must be natural persons in order for the exception in section 72(u)(1) for contracts held by a trust or other entity as an agent for a natural person to apply.

PLR 202031008 – Questions, alternative views

- Implications for Code § 72(s)?
  - Requires distributions upon death of any <u>holder</u>
  - If holder is not an individual, primary annuitant is treated as holder
  - Very similar to Code § 72(q)(2)(B) – death of holder
  - Could a grantor trust be disregarded for tax purposes, thereby treating the grantor as the holder?
  - Can avoid uncertainty by requiring the grantor and annuitant to be the same
- Simple vs. complex non-grantor trusts?
  - Could a trust beneficiary be viewed as the taxpayer?
  - Can the answer differ for simple trusts and complex trusts?
- Changes in trust status?
  - If the status of the trust under the grantor trust rules matters, what happens if that status changes?

Rev. Rul. 2020-24 and Rev. Proc. 2020-46

ESCHEATMENT: REPORTING, WITHHOLDING, & ROLLOVERS

ITC Insurance Tax Conference

Rev. Rul. 2020-24 – Reporting & Withholding

- Addresses reporting and withholding for certain distributions from employer plans
  - Traditional qualified plan under Code § 401(a) – no Roth account
  - Also no investment in the contract (basis), no health & welfare benefits, no employer securities
  - Participant is a U.S. person who did not make a withholding election
  - Entire accrued benefit paid to state unclaimed property fund, net of any applicable withholding
- Conclusion #1: Withholding required under Code § 3405
  - Under the assumed facts, no statutory exception and not reasonable to conclude that the amount is not includible in gross income
- Conclusion #2: Reporting required under Code § 6047(d)
- Transition rule: Must comply by the *earlier* of 1/1/22 or "the date it becomes reasonably practicable"
- Similar guidance in Rev. Rul. 2018-17 for traditional IRAs

Rev. Rul. 2020-24 – Open questions

- What if the distribution includes excludable amounts (Roth, etc.)?
- What if the plan previously reported the amount in question? For example:
  - The plan sends the participant a check and reports and withholds on the payment
  - The check is returned uncashed
  - Later, plan pays the amount to a sate unclaimed property fund
  - Report and withhold again?
- Form 1099-R distribution code?
- Code § 1441 presumption rules?
- ERISA?
- Implications for non-qualified annuities?

Rev. Proc. 2020-46 – Escheatment & Rollovers

- IRS can waive failure to satisfy 60-day rollover requirement in certain circumstances
  - Code §§ 402(c)(3)(B) and 408(d)(3)(I)
- Rev. Proc. 2016-47: Lists permitted reasons for self-certification of eligibility for waiver
  - Conditions apply
  - IRA providers and plan administrators can rely on self-certification
  - Subject to IRS examination and redetermination
- Rev. Proc. 2020-46
  - Adds new reason: distribution to state unclaimed property fund
  - Provides updated model language

WITHHOLDING RULES FOR PERIODIC PAYMENTS

Final Regulations

- Final regulations published 9/28/20
- Address default rate of withholding that applies under Code § 3405(a)(4) to periodic payments when no withholding certificate is in effect
  - Change necessitated by TCJA, which amended the statute to replace the "married with three withholding exemptions" rule with a delegation of authority to IRS for years after 2017
  - Since then, IRS has left the old rule in place, pending new regulations
- New rule in final regulations is not substantive – merely says that default rate will be specified in IRS forms, instructions, publications or other guidance
- This means the IRS can change the rules in the future more quickly by simply changing Form W-4P and related materials

Revisions to Form W-4P

- IRS released a draft of a revised Form W-4P in July 2020
  - Align with re-designed Form W-4
  - Much more complicated, requires payees and payors to take into account other sources of income
  - Proposed to make it effective for 2021
  - But IRS later postponed
- New form will be released in the future
  - Old rules will apply at least through 2021 (note that TCJA sunsets in 2026)
  - IRS will consider industry comments when revising form for years after 2021

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PLR 202041005 and

PLR 202041002 (revising PLR 201235001)

INVESTOR CONTROL AND PENSION PLAN CONTRACTS

Facts of the Rulings

- Facts not identical but very similar
- Insurer issues variable "pension plan contracts" under Code § 818(a)
- Separate account invests in certain real estate assets
- Issuer proposes to restructure the separate account investments:
  - "Substantially all" will be held indirectly through a publicly-available fund
  - The rest will be held directly by the separate account ("Directly Held Assets")
- Issuer made various common representations to show that the policyholder pension plans do not control the investment decisions
- New unique representation: The separate account generally will maintain "x percent" of its assets (other than cash and cash equivalents) in Directly Held Assets, determined yearly using a 5-year rolling average

IRS Analysis

- Investor control doctrine has two prongs: actual control and public availability
- Actual control prong addressed by taxpayers' representations that are common to these types of rulings – no input on investments, etc.
- Public availability prong addressed in part by taxpayers' representations regarding the relative value of the Directly Held Assets
  - This prong "generally provides that when the sole asset held by a separate account is available for purchase other than through the purchase of [variable contracts], the contract holder will be treated as the owner of the asset held by the separate account. See Rev. Rul. 81-225; Rev. Rul. 2003-92."
  - "In such circumstances, the contract holder's position is substantially identical to what his or her position would have been if he or she had directly or indirectly (as in Situation 4 of Rev. Rul. 81-225) purchased an interest in the asset held by the separate account."
  - The relative size of the Directly Held Assets helped distinguish the overall portfolio of assets in the separate account from a direct investment in the publicly-available fund in which the separate account invested substantially all of its assets

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