IRS Issues Final Regulations On Longevity Annuities

Insights
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With the goal of providing retirees with more options to manage their retirement income, the IRS issued final regulations on "qualified longevity annuity contracts" (QLACs). A QLAC is a type of deferred annuity that commences at an advanced age and continues for the life of the retiree.

A QLAC can be offered under a defined contribution plan such as a 401(k), 403(b), and 457(b) plan, or other employer-sponsored individual account plans, as well as IRAs (except Roth IRAs). This rule allows retirees to spend a portion of their retirement savings on a lifetime income stream, while retaining other assets in readily accessible investments.

Here is an overview of the rules:

- the maximum amount of retirement savings that can be used to purchase a QLAC is the lesser of 25% of the account balance or $125,000, adjusted in increments of $10,000 for cost-of-living increases;
- any amount used to purchase a QLAC will not be included in the amount used to calculate the retiree's minimum required distribution;
- a QLAC can have a return-of-premium feature that guarantees that all premiums are recouped from the annuity carrier if the retiree dies before receiving annuity payments equal to the full amount of premiums paid – the excess is payable to a beneficiary (this type of annuity may be a little more expensive but appeals to individuals who want to provide a benefit to their heirs should they die before the entire premium amount is paid out to them);
- distributions under a QLAC must begin no later than age 85;
- the final regulations stipulate that the QLAC cannot be a variable annuity contract, an indexed contract or a similar contract; and
- the annuity contract must state that it is intended to be a QLAC at the time of issue.

These regulations apply to contracts purchased on or after July 2, 2014.

So who would use a QLAC? Employees concerned that they might outlive the IRS minimum required distribution (MRD) table should consider this new option. Let's assume an employee retires with a large 401(k) balance. MRDs are required when an employee reaches age 70½. At age 70, the employee purchases a QLAC with $125,000 of the account balance. The QLAC is to begin payment at employee purchases a QLAC with $125,000 of the account balance. The QLAC is to begin payment at age 85. The employee has removed the $125,000 from the MRD rules and created a guaranteed income at age 85 of between $32,500 and $52,500 a year (depending on insurance company assumptions).

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LIMITATION ON IRA-TO-IRA ROLLOVER

The IRS has announced that it is reversing its long-established position on IRA rollovers and intends to follow the Tax Court decision in Bobrow v. Commissioner which held that an individual can only withdraw money from an IRA and roll it over to another IRA once in a 12-month period. This limit applies no matter how many IRAs an individual has.

Thus individuals cannot make IRA-to-IRA rollovers if they have made an IRA-to-IRA rollover in the preceding one-year period. This interpretation of the rollover rules does not affect the ability of an IRA owner to transfer funds from one IRA trustee or custodian directly to another. The IRS will not apply this interpretation to any rollover occurring before January 1, 2015.