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Qualified Longevity Annuity Contracts: Income for Later in Life

Generally, annuity contracts have fees and expenses, limitations, exclusions, holding periods, termination provisions, and terms for keeping the annuity in force. Any guarantees are contingent on the claims-paying ability and financial strength of the issuing insurance company. It is important to understand that purchasing an annuity in an IRA or an employer-sponsored retirement plan provides no additional tax benefits than those available through the tax-deferred retirement plan.

You may hope to live to an old age, but a longer life means that you'll have even more years of retirement to fund. You may even run the risk of outliving your savings and other income sources.

Even though you may have set aside funds for retirement, you may not have set aside enough to cover your needs into very old age. How can you address the risk of outliving your savings? One option worth considering is a longevity income annuity.

What is a longevity annuity?

A longevity annuity, also referred to as a longevity income annuity or a deferred income annuity, is a contract between you and an insurance company. As the insured, you deposit a sum of money (the premium) with the company in exchange for a stream of payments to begin at a designated future date (typically at an advanced age) that will last for the rest of your life. The amount of the future payments will depend on a number of factors, including the amount of your premium, your age, your life expectancy, and the time when payments are set to begin.

That's the basic concept, although some longevity annuities may offer other options (possibly for an additional cost) including:

- The opportunity to make additional premium contributions up to the date annuity payments are to begin
- Cost-of-living adjustments that can increase annuity payouts
- Death benefit or return of premium to your annuity beneficiary if you don't live long enough to receive payments equal to the amount of your total contributions to the longevity annuity
- The option to "cash out" the longevity annuity prior to the time payments are to begin, although this usually involves surrender fees that likely will reduce the amount returned to you

Caution: *Guarantees are subject to the claims-paying ability and financial strength of the annuity issuer.*

Longevity annuity in a tax-qualified plan: QLAC

Some or all of your retirement savings may be held in tax-qualified retirement plans such as 401(k), IRA, 457(b), or 403(b) plans. If you are a plan participant or IRA owner, you may be able to purchase a longevity annuity within your retirement plan (excluding Roth IRAs and inherited IRAs). Annuities that comply with regulations issued by the IRS are referred to as qualified longevity annuity contracts, or QLACs. The IRS regulations may be viewed at irs.gov.

There are special rules and limitations that specifically apply to QLACs that are not necessarily applicable to non-qualified longevity annuity contracts (NQLACs). Here are some of the limitations and requirements applicable to QLACs.

Premiums

No more than $125,000 (this limit is indexed for inflation in $10,000 increments) of your combined tax-qualified retirement plan balances may be allocated to QLACs. Additionally, no more than 25% of any particular retirement plan balance may be applied to a QLAC. For IRAs, the 25% is based on the combined balances of all your IRAs. These premium limitations apply separately to the retirement accounts of each spouse, so each spouse could have up to $125,000 of his or her retirement account allocated to QLACs. If an annuity contract fails to be a QLAC solely because premiums for the contract exceed the premium limits, then the contract will not fail to be a QLAC if the excess premium is returned to the non-QLAC portion of your account by the end of the calendar year following the calendar year in which the excess premium was paid.

Required minimum distributions

Generally, required minimum distributions (RMDs) are amounts that you must withdraw each year from your traditional IRA, employer-sponsored retirement plan, or tax-sheltered annuity. You must begin to take the

Contributions to a traditional IRA are tax deductible (subject to certain income limits), and any earnings in the account are not subject to income tax until withdrawn. IRA withdrawals (also called distributions) are subject to ordinary income tax (except for any nondeductible contributions you've made). Taxable distributions taken prior to age 59½ may be subject to an additional 10% federal income tax penalty, with certain exceptions such as the owner's death, disability, or a first-time home purchase ($10,000 lifetime maximum).

annual distributions by April 1 of the year following the year in which you reach age 70½, although some exceptions may apply. An important provision of the IRS regulations relative to QLACs allows you to bypass required minimum distribution rules.

According to the regulations, a QLAC purchased on or after July 2, 2014, may be exempted from RMD rules. In other words, the amount of the QLAC is not included in calculating your required minimum distributions. This is an important provision because you effectively do not have to begin taking distributions from your QLAC until much later in life (e.g., age 85), thus potentially reducing the amount of your RMDs in earlier years.

Annuity type

To qualify as a QLAC, the annuity contract must state that it is a QLAC. The annuity contract is a fixed annuity, and can not be a variable or indexed contract. And it must be a deferred annuity, meaning that payments to you will begin at some future date.

Annuity payments

Annuity payments from a QLAC must follow certain guidelines (some of which are not applicable to NQLACs), including:

- Payments can begin anytime after reaching age 70½, but no later than the first day of the month immediately following your 85th birthday
- Payments must be made over your lifetime, or over the lifetimes of you and a named beneficiary (joint annuity)
- Payments must be made at least annually
- Payment amounts may not increase over the term of the annuity for you or your beneficiary
- QLACs can't allow "cash out" provisions such as commutation benefits (e.g., no lump sum payment), cash surrender amounts, minimum guaranteed payment periods, or withdrawals during the deferral period, except to correct an excess premium or purchase payment

Death benefits

A QLAC may provide for death benefits both before and after annuity payments to you have begun. However, the rules governing the amount of death benefit payments may differ depending on whether the beneficiary is your surviving spouse, and whether payments to you have begun prior to your death.

A QLAC may offer a return of premium (ROP) feature (for an additional cost) that is payable before and after the annuity starting date. Accordingly, a QLAC may provide for a single-sum death benefit paid to a beneficiary in an amount equal to the excess of the premium payments made over the annuity payments made to you under the QLAC. However, if the ROP is not available or if you don't elect it, no payments will be made if you die before the QLAC payment start date.

If a QLAC provides a life annuity to your surviving spouse, it may also provide a similar ROP benefit after the death of both you and your spouse. An ROP payment must be paid no later than the end of the calendar year following the calendar year in which you die, or in which your surviving spouse dies, whichever is applicable.

If the sole beneficiary is your surviving spouse, the only benefit permitted to be paid after your death (other than an ROP) is a life annuity payable to your surviving spouse that does not exceed 100% of the annuity payment otherwise payable to you. However, annuity payments must also comply with rules for qualified preretirement survivor annuities and qualified joint and survivor annuities.

Is a QLAC right for you?

As with most investment options, you should carefully consider whether a QLAC is right for you. With a QLAC, you can't access account funds if you need money--no withdrawals are allowed. So it's important that you have other funds available during the deferral period (i.e., before QLAC payments begin).

Keep in mind that the investment returns of the QLAC during deferral could be lower than what you could have earned if you invested on your own. In addition, the longer your QLAC is in deferral, the more it'll be worth (and the greater your annuity payments will be), so the longer you live, the more you'll receive when QLAC payments start--presuming you live long enough to receive payments.

A QLAC may not be available as an investment option in your employer-sponsored retirement plan, if the plan sponsor does not offer a QLAC as an investment option.