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New IRS Regulations Permit the Purchase of Longevity Annuities by Qualified Retirement Plans

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Under the directive of providing individuals with additional lifetime income options, the **IRS** issued final regulations on July 2, 2014, permitting the purchase of **longevity annuity contracts**. The regulations apply to participants in certain types of **retirement plans** and **IRA owners** and allows them to purchase a **"qualifying longevity annuity contract"** (QLAC) with a portion of their account balance. According to the regulations' accompanying press release:

> *This change will make it easier for retirees to consider using lifetime income options: instead of having to devote all of their account balance to annuities, retirees who wish to follow a combination strategy that uses a portion of their savings to purchase guaranteed income for life while retaining other savings in more liquid or flexible investments will be able to do so.*

Prior to these regulations, the value of an annuity contract held under a defined contribution plan that had not been annuitized was treated as an individual account for purposes of the required minimum distribution (RMD) rules. Generally, the minimum distribution rules state that distributions from a retirement plan must begin by the required beginning date (RBD) which is (i) age 70 ½, or (ii) retirement.

Including non-annuitized amounts in the RMD calculation caused the RMD payments to be higher and individuals to draw from their account quicker than they might otherwise need. Under the QLAC regulations, the value of a QLAC that has not been annuitized is not included in the account balance used to determine RMDs.

What types of retirement arrangements may maintain QLACs?

Defined contribution plans under Code § 401(a), Code § 403(b) plans, eligible deferred compensation plans under Code § 457(b), and Code § 408 IRAs are all permitted to use QLACs to defer distributions under their respective minimum distribution requirements. QLACs are not available to participants in a defined benefit retirement plan.

What is a qualifying longevity annuity contract?

Although QLACs permit the deferral of distributions until later in life, the IRS has put in place limitations to prevent an indefinite deferral by requiring distributions to begin by age 85. The deferral of distributions is also limited by allowing only a portion of the individual account balance to be used towards the payment of premiums – which is capped at the lesser of (i) $125,000, or (ii) 25% of the account balance.

As for the contract itself, it must expressly state that it is intended to be a QLAC. These annuity contracts may not be a variable, indexed, or a similar type of annuity contract. A QLAC also cannot provide any commutation benefit, cash surrender right, or other similar feature. However, a return of premium feature is permitted so long as it is paid no later than the end of the calendar year following the year in which the employee, or surviving spouse, dies.

The QLAC regulations also place limitations on the benefits payable after the employee's death. Generally, however, life annuities are payable to the beneficiaries subject to limitations based upon whether the annuity start date occurred before or after the employees death and whether the surviving spouse is the sole beneficiary.

What does this mean for retirement plan sponsors and administrators?

These regulations will make it easier for plan sponsors to offer annuity options in their retirement plans and will offer plan participants an additional type of investment option. If QLACs are added to a plan, plan language will need to be reviewed to ensure that there is no conflict between the plan's distribution provisions and the QLAC distribution provisions.

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