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IRS Issues Final Regulations on Longevity Annuity Contracts

Longer life expectancy and the likelihood of more years spent in retirement are realities now facing the baby boom generation, and in all likelihood, the generations that will follow. This may be a mixed blessing if a retiree does not save—and preserve—sufficient financial resources for a secure retirement. Outliving our resources is a very real concern for American workers, and consequently for the nation's policymakers and lawmakers.

Some attribute a concerned attitude towards retirement preparedness at least in part to a shift away from defined benefit (DB) pension plans, with their typical guaranteed lifetime payout options, to defined contribution (DC) plans—like 401(k)s—that place accumulation and investment responsibility more squarely on the shoulders of workers. Others point to the requirement that most retirees begin receiving and being taxed on their Traditional IRA and employer plan assets at age 70½, rather than being allowed to the preserve these assets until needed.

History of the Longevity Annuity Rules

In February 2012, the IRS published proposed regulations outlining a new type of annuity contract referred to as a "qualified longevity annuity contract (QLAC)." As proposed, a QLAC is an annuity contract that meets certain requirements and is purchased with assets in Traditional IRAs, or certain retirement plans (including defined contribution qualified retirement plans, 403(b) plans, and eligible governmental 457(b) plans). The regulations proposed limitations on the amount of assets that can be used for QLACs, would not require distributions until age 85, and would reduce balances used to calculate RMDs.

Two years later, following a public hearing and the receipt of written comments, these final regulations affirm most of the guidance contained in the proposed regulations, with several modifications to accommodate input received.

What These Regulations Do

The proposed—and now final—longevity annuity regulations do three important things.

1. Modify the RMD rules to promote asset preservation
2. Define qualifying criteria for an annuity product that will begin payout at an advanced age
3. Describe disclosures that must be provided for such an annuity

RMD Calculation Changes

RMDs from Traditional IRAs and employer-sponsored retirement plans generally must begin at age 70½ and are based on prior year-end account balances. These final regulations affirm that account balances used to determine RMDs will be reduced by the QLAC premium cost within such plans—thereby reducing the taxpayer's RMD. When the QLAC annuity starting date is reached (no later than age 85), the annuitized QLAC will satisfy the RMD requirements for that investment.

Qualifying Longevity Annuity Contract Requirements

An annuity contract must meet certain conditions (highlighted below) to be considered a QLAC. Roth IRAs (which are not subject to the RMD rules) and defined benefit plans (which already offer annuities and longevity protection) are specifically excluded under the QLAC regulations. The total premium amounts paid from eligible plans to purchase one or more QLACs cannot exceed the lesser of the dollar limit or the percentage limit.

1. <u>Dollar Limit</u>: $125,000, cumulative for a taxpayer's applicable plan balances and Traditional IRAs. This amount will be indexed for inflation in $10,000 increments.

   NEW: Increased from the proposed regulations limit of $100,000; decreased the proposed regulations indexing increment of $25,000.

2. <u>Percentage Limit</u>: 25% of the account balance of the individual on whose behalf the QLAC was purchased in an employer plan. The limit is reduced by premiums previously paid on behalf of the individual for the QLAC or any other QLAC under such plan. The 25% limit applies separately to the aggregate of all Traditional IRA account balances of an individual.

   NEW: The final regulations relax a proposed regulations rule that would have disqualified an entire QLAC contract if a premium amount ($125,000) or percentage (25%) violation occurred. The final regulations permit a correction by the end of the calendar year following the calendar year in which the excess premium was paid.

- In determining whether a QLAC purchase under an employer-sponsored plan is within the limitations described above, the plan administrator or Traditional IRA trustee, custodian, or issuer has some relief. The administrator, trustee, custodian, or issuer may generally rely on the representations of the participant or IRA owner with respect to premiums paid for contracts under other plans, unless they have actual knowledge to the contrary. Distributions under the QLAC must begin no later than the first day of the month following the attainment of age 85. This age may be adjusted for future changes in life expectancy. A QLAC could, but is not required to, provide an option to begin payments before the contract's annuity starting date.
- Distributions under the QLAC must satisfy the RMD regulations that apply to annuity contracts (e.g., the contract may not provide for increasing payments).
- A QLAC may contain no cash surrender or similar value and may not be a variable or indexed annuity product (though the IRS has the authority to provide exceptions through other guidance).
- Payments to a beneficiary must be in the form of a life annuity.

  NEW: A QLAC *may* contain a return-of-premium feature, which allows a QLAC beneficiary to receive premiums that the annuitant had paid, but not received, before death.

NEW: The final regulations maintain the proposed regulations requirement that an annuity contract intended to be a QLAC—whether individual or group annuity—must state this *in the contract* when issued. However, this requirement can be satisfied by including the information in a contract rider or endorsement to prevent having to again file the contracts with state insurance authorities.

NEW: The final regulations also provide a transition rule for any QLAC issued before January 1, 2016, which may satisfy the above requirement if the contract is amended, or a rider or endorsement provided, no later than December 31, 2016.

Disclosure and Reporting Requirements: IRS

The QLAC issuer must file an annual report with the IRS and provide a statement to the individual on whose behalf the QLAC was purchased, starting in the year of first premium payment and ending with the earlier of such individual's death, or reaching age 85. If a spouse is the contract's sole beneficiary, this report must continue to be filed until payments to the beneficiary begin. In addition to noting that the contract is a QLAC, it must contain the following information.

- Identifying information for the issuer of the contract and who to contact for additional information
- Identifying information for the individual on whose behalf the contract is purchased
- Identifying information for the plan sponsor, if the contract was purchased under an employer plan
- The annuity starting date, the amount of the annuity payable on that date, and whether the annuity starting date may begin earlier
- For the calendar year, the amount of each premium paid, along with the date of payment
- The total amount of all premiums paid to-date through the end of the calendar year
- The fair market value of the QLAC as of the close of the calendar year

The IRS will create a form and instructions for this purpose, which will contain the filing deadline and other information.

New: Disclosure and Reporting Requirements: Participant/Contract Purchaser

The final regulations depart significantly from the proposed regulations' requirement that an individual on whose behalf a QLAC is purchased be provided an initial report containing information on QLAC premium restrictions, annuity starting date and benefit information, administrative procedures, elections, and other items. Instead, the final regulations cite existing account disclosure practices under ERISA and state insurance laws as likely to provide this information. The final regulations note, however, that this could change if it is determined "that employees are not receiving enough information before a QLAC is purchased."

Effective Date

These final regulations are effective as of the date of publication in the *Federal Register*, July 2, 2014.