EMPLOYEE BENEFITS & PENSIONS

Retiree Tax Planning With Qualified Longevity Annuity Contracts

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PREVIEW

- As the population ages and retirees' life expectancies increase, deferred annuities, which protect against retirees' outliving their retirement savings, will become more important.
- The new qualified longevity annuity contract (QLAC) rules provide tax benefits for the purchase of qualifying deferred annuities within certain defined contribution plans and IRAs.
- As with all tax-favored retirement vehicles, specific rules apply to QLACs. Practitioners need to know these rules to properly advise clients.

As life expectancy in the United States continues to increase, more retirees have a new worry—outliving their retirement savings. In response to this concern,[1] the IRS recently issued regulations authorizing a new type of annuity contract for certain tax-favored retirement plans and IRAs.[2] The new contract is a qualified longevity annuity contract (QLAC).

The IRS designed QLACs to alleviate some of the risk that a retiree would outlive his or her retirement benefits. That risk is particularly acute for retirees who have retirement plans and IRAs that do not normally pay life annuities.[3]

For these plans or IRAs, the amount of the required minimum distribution (RMD) a participant must take each year generally depends on a participant's account balance. For each year beginning with the year the participant reaches age 70½ (or later retirement in some cases),[4] the plan or IRA must distribute a minimum amount equal to the prior year's adjusted account balance divided by a distribution period. The retiree finds the distribution period each year by reference to his or her age in an IRS actuarial table.[5]

> ***Example 1:*** *R*, a retiree, is age 73 on her birthday in the year 2014, and the adjusted account balance of her IRA was $400,000 at the end of 2013. *R* computes the RMD of $16,194 for 2014 by dividing the adjusted account balance of $400,000 by the 24.7 years found in the IRS table for a retiree age 73.
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> For the following year, 2015, assume the adjusted account balance at the end of the last year was $420,000. *R* computes the RMD of $17,647 for 2015 by dividing the adjusted account balance of $420,000 by the 23.8 years found in the IRS table for a retiree age 74 (one year older).

Since RMDs depend on the retiree's age, his or her account balance, and the IRS's actuarial tables, it is quite possible for a retiree to deplete or greatly reduce the funds in his or her plan or IRA before he or she dies. That is, a retiree may receive distributions over a longer period than anticipated because he or she lives longer than expected. Or the plan or IRA may suffer equity market losses or other plan losses that reduce the account balance.

Inadequacy of Past Solutions

In the past, a retiree might have hedged the risk of depleting retirement funds by having the plan or IRA use some of its initial account balance to purchase a deferred annuity. The deferred annuity could have provided that it would start payments when the retiree reached a specified advanced age (e.g., age 85).

Unfortunately, though, for the year the annuity began and all prior years, the then-controlling tax law required the retiree to include the actuarial value of the deferred annuity in his or her account balance.[6] Thus, early minimum distributions based on this inflated account balance were generally larger than desired. As a consequence, the retiree would often find it necessary to start deferred annuity payments earlier than planned, just to continue to satisfy the minimum distribution requirements. QLACs now offer a solution to this problem.

Definition and Requirements of a QLAC

A QLAC is a specific type of annuity purchased for a participant in a qualified defined contribution plan, a Sec. 403(b) plan, a Sec. 457 governmental plan, or an IRA (other than a Roth IRA).[7] The annuity contract must state that the contract is a QLAC.[8] It must start paying the annuity no later than the first day of the month coincident with or immediately following the participant's 85th birthday,[9] but it may also allow the participant to elect an earlier starting date.[10] In addition, the aggregate premiums paid for all QLACs benefiting a participant may not exceed certain dollar and percentage limitations described below.[11]

A QLAC generally must be payable over a retiree's lifetime or over the lifetimes of the retiree and a beneficiary.[12] The QLAC must also satisfy all the usual minimum distribution requirements for annuities (other than the requirement to begin payments by April 1 of the calendar year following age 70½).[13] For example, the regular interval between the annuity payments may not exceed one year. And, subject to some specific exceptions, the

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1. Preamble to REG-115809-11: "Purchasing longevity annuity contracts could help participants hedge the risk of drawing down their benefits too quickly and thereby outliving their retirement savings. This risk is of particular import because of the substantial, and unpredictable, possibility of living beyond one's life expectancy."
2. T.D. 9673, effective for annuity contracts purchased after July 1, 2014, or contracts received in exchange for existing contracts after that date (Regs. Sec. 1.401(a)(9)-6, Q&A 17(e)).
3. A recent survey found that 30% of affluent Americans wanted to plan financially for the possibility of living to 100. The survey also revealed that the risk of outliving retirement assets was a significant concern for 54% of men and 66% of women (*Merrill Lynch Affluent Insights Survey*, Feb. 22, 2012).
4. Sec. 401(a)(9)(C)(i); Regs. Secs. 1.401(a)(9)-2, Q&A 2(a), and 1.408-8, Q&A 3.
5. Regs. Secs. 1.401(a)(9)-5, Q&As 1 and 4, and 1.401(a)(9)-9, Q&A 2, Uniform Lifetime Table.
6. Regs. Sec. 1.401(a)(9)-6, Q&A 12; Regs. Sec. 1.401(a)(9)-5, Q&A 1(e).
7. Sec. 457(d)(2); Regs. Secs. 1.401(a)(9)-5(d); 1.403(b)-6(e)(9); 1.408-8, Q&A 12; and 1.408A-6(d).
8. Regs. Sec. 1.401(a)(9)-6, Q&A 17(a)(6). The statement may be made by rider or endorsement, or in a group annuity certificate (id.; Regs. Sec. 1.401(a)(9)-6, Q&A 17(d)(5)).
9. Regs. Sec. 1.401(a)(9)-6, Q&A 17(a)(2).
10. Regs. Sec. 1.401(a)(9)-6, Q&As 17(c)(2)(iv)(B) and 17(c)(3); preamble to T.D. 9673.
11. Regs. Sec. 1.401(a)(9)-6, Q&A 17(a)(1).
12. The regulations do not expressly state that QLAC payments to a participant cannot be in the form of an annuity for a term of years. However, the possibility of non–life payments to a beneficiary of a participant who died before the end of the term of years would appear to violate the QLAC requirement that the only benefit payable to a beneficiary is a life annuity (or the return of premiums exceeding previous annuity payments to the participant) (Regs. Sec. 1.401(a)(9)-6, Q&A 17(a)(5)).
13. Regs. Sec. 1.401(a)(9)-6, Q&A 17(a)(3).

amount of the annuity payments may not increase over the term of the annuity or upon the retiree's death.[14]

A QLAC cannot provide commutation benefits, cash surrender rights, guaranteed payments, or other similar features.[15] Nor may a variable or indexed contract qualify as a QLAC.[16] The only QLAC benefits allowed after a participant's death are life annuities paid to a designated beneficiary (or the return of premiums exceeding previous annuity payments to the participant).[17] A designated beneficiary is an individual entitled to benefits after the retiree's death who is designated as a beneficiary under the plan or arrangement.[18]

Advantages of a QLAC

A QLAC significantly increases tax deferral by delaying annuity payments until an advanced age. Earlier minimum distributions are smaller than usual since the value of the QLAC is excluded from the account balance used to compute those distributions.[19] Most importantly, though, a QLAC provides some additional financial security for a retiree who outlives his or her life expectancy or suffers through a downturn in the equity markets.

The Dollar and Percentage Limitations on QLAC Premiums

Aggregate QLAC premiums paid during a participant's lifetime by all his or her plans and IRAs may not exceed $125,000 (adjusted for inflation). Also, the cumulative premiums paid by any one plan may not exceed 25% of the plan's account balance (including the value of any QLAC) on the date of a premium payment.[20] However, all of a taxpayer's IRAs are treated as a single plan for purposes of applying the percentage limitation. In addition, a participant must determine IRA account balances as of Dec. 31 of the year preceding the year of the latest premium payment.[21]

> ***Example 2:*** *R*, a retiree, is a participant in plan *M*, a qualified defined contribution plan. Plan *M* owns a QLAC for which it previously paid a premium of $50,000. *R* also owns IRA *J* with an account balance of $125,000 and IRA *K* with an account balance of $75,000 (both balances determined as of the preceding Dec. 31). *R* wants IRA *K* to pay a premium of $45,000 for an additional QLAC.
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> The premium paid by IRA *K* will satisfy the dollar and percentage limitations. The cumulative premium payment of $95,000 will be less than the $125,000 limit. The $45,000 premium payment by IRA *K* will also be less than the $50,000 percentage limitation (i.e., less than 25% of the $200,000 combined balances of IRAs *J* and *K*).

An annuity contract acquired by paying a premium that cumulatively exceeds the dollar or percentage limitation cannot be a QLAC. Thus, the annuity contract to be acquired by IRA *K* in Example 2 would not be a QLAC if the premium exceeded 25% of the combined account balances of IRAs *J* and *K*.

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14. Sec. 401(a)(9)(A)(ii); Regs. Sec. 1.401(a)(9)-6, Q&A 1(a).
15. Regs. Sec. 1.401(a)(9)-6, Q&A 17(a)(4). However, commutation benefits do not include the cancellation of that portion of an annuity contract attributable to excess premiums if the excess premiums are timely returned or corrected (Regs. Sec. 1.401(a)(9)-6, Q&A 17(d)(1)(ii)(C)).
16. Regs. Sec. 1.401(a)(9)-6, Q&A 17(a)(7); Regs. Sec. 1.408-8, Q&A 12(d). However, the IRS has authority to allow some such contracts by future publication. Id. In addition, a contract is not a variable or indexed contract merely because it provides for dividends or cost-of-living adjustments (Regs. Sec. 1.401(a)(9)-6, Q&A 17(d)(4)).
17. Regs. Sec. 1.401(a)(9)-6, Q&A 17(a)(5).
18. Regs. Sec. 1.401(a)(9)-4, Q&A 1.
19. Regs. Sec. 1.401(a)(9)-5, Q&A 3(d).
20. Regs. Sec. 1.401(a)(9)-6, Q&As 17(b) and 17(d)(2)(i). A plan's account balance on the date of a premium payment is equal to the account balance as of the plan's preceding valuation date, increased by subsequent contributions and decreased by subsequent distributions (Regs. Sec. 1.401(a)(9)-6, Q&A 17(d)(1)(iii)).
21. Regs. Sec. 1.408-8, Q&A 12(b)(3).

EXECUTIVE SUMMARY

- New regulations permit taxpayers to use part of the balance in their defined contribution plan or IRA to purchase qualified longevity annuity contracts (QLACs), a form of deferred annuity that can begin making payments as late as the year the taxpayer is 85 years old.

- Contributions to pay QLAC premiums are excluded from the remaining account balance when calculating required minimum distributions (RMDs). This reduces the amount of a retiree's RMDs in earlier years, generally allowing the retiree to increase his or her tax deferral by starting payments under the annuity contract at a later age.

- QLACs can be designed to pay benefits over the lifetime of the retiree or of the retiree and a beneficiary. While annuity benefits can be paid to a surviving spouse or other beneficiary, specific rules govern the amount they can be paid. The amount a retiree can invest in a QLAC is also subject to limitations.

- QLACs purchased by married taxpayers must comply with the qualified joint and survivor annuity and the qualified preretirement survivor annuity rules, but a spouse may agree to waive these requirements.

A QLAC is a specific type of annuity purchased for a participant in a qualified defined contribution plan, a Sec. 403(b) plan, a Sec. 457 governmental plan, or an IRA.

Consequently, the value of the contract would be included in the account balance of IRA *K* for purposes of computing RMDs for the year the annuity starts and for all prior years.[22]

Nevertheless, a contract with an excess premium need not be disqualified in its entirety. The insurer may return the premium paid that exceeds the dollar or percentage limitation and cancel a corresponding portion of the contract. Or the insurer may issue a separate non-QLAC contract for the excess premium. In either event, the plan or IRA must receive the returned premium or non-QLAC contract by the end of the calendar year following the year of the original premium payment.[23]

Note also that, if a contract is disqualified as a QLAC because premiums exceed the $125,000 limitation, the contract cannot subsequently qualify merely because the IRS increases the dollar limitation to account for inflation. (Similarly, a contract disqualified because it starts later than age 85 cannot subsequently qualify merely because the IRS later raises the allowable starting age to accommodate new mortality data.)[24]

Surviving Spouse as Sole Beneficiary of a QLAC

A QLAC may provide a life annuity to a spouse who is the sole beneficiary of a retiree who died while receiving QLAC payments. However, the spouse's periodic payment may not be larger than the periodic payment the retiree was receiving.[25]

> ***Example 3:*** *R*, a retiree, is age 85 when he begins receiving QLAC payments of $2,000 per month for life. Upon *R*'s subsequent death, his surviving spouse becomes entitled to monthly annuity payments for her lifetime. Minimum distribution requirements will be satisfied only if *R*'s surviving spouse receives monthly payments for her life of no more than $2,000.

A QLAC may also provide a life annuity to a spouse who is the sole beneficiary of a participant who dies before his or her annuity starting date. The spousal annuity payments must commence on or before the date that would have been the participant's annuity starting date. The spouse's periodic payment generally may not be larger than 100% of the periodic payment the participant would have received had he or she survived and elected to commence payments on the spouse's annuity starting date.[26] Nevertheless, the spousal payments may exceed 100% if larger payments are needed to satisfy the rules for qualified preretirement survivor annuities (QPSAs), which are discussed below.[27]

> ***Example 4:*** *R*, a retiree, is entitled to QLAC payments of $2,000 per month starting at age 85. After *R*'s death, his younger spouse will be entitled to monthly annuity payments for her lifetime, starting when the retiree would have reached age 85. If *R* dies at age 80, the minimum distribution requirements are satisfied only if *R*'s surviving spouse receives monthly lifetime payments of no more than $2,000 starting when *R* would have reached age 85.

> ***Example 5:*** Assume the same facts as in Example 4, except *R*'s spouse receives monthly annuity payments for her lifetime starting *before R* would have attained age 85. Assume the spouse's annuity starts on the last day of the year following *R*'s death (when the retiree would have been 81). Further assume the QLAC issuer determines that *R* would have been paid $1,500 per month if he had lived and received annuity payments starting on the last day of that year. Minimum distribution requirements are satisfied only if the surviving spouse's annuity payments are no more than $1,500 per month.

Surviving Spouse Not Sole Beneficiary of a QLAC

If a participant's surviving spouse is not a QLAC beneficiary, or is not the sole beneficiary, the contract may provide a life annuity to a designated beneficiary only if *one* of the following two conditions is satisfied.

1. The contract forbids payments to any beneficiary if the participant (a) dies before his or her annuity starting date or (b) dies within 90 days after electing an earlier annuity starting date.
2. The participant irrevocably selects a designated beneficiary by the later of

22. Regs. Sec. 1.401(a)(9)-6, Q&As 12(a) and 17(d)(1)(ii)(A); Regs. Sec. 1.401(a)(9)-5, Q&As 1(e) and 3(d).
23. Regs. Sec. 1.401(a)(9)-6, Q&A 17(d)(1)(ii)(B).
24. Regs. Sec. 1.401(a)(9)-6, Q&A 17(d)(2)(iii).
25. Regs. Sec. 1.401(a)(9)-6, Q&A 17(c)(1)(i).
26. Regs. Sec. 1.401(a)(9)-6, Q&A 17(c)(1)(ii). The contract must provide a way to determine the amount of the annuity payment the participant would have hypothetically received if, for example, the spouse's annuity starting date occurred before the earliest starting date available to the participant (Regs. Sec. 1.401(a)(9)-6, Q&A 17(c)(3)).
27. Regs. Sec. 1.401(a)(9)-6, Q&A 17(c)(1)(ii).

(a) the date of purchase of the QLAC or (b) April 1 of the first full calendar year after the participant reaches age 70½ (or after later retirement in some cases).[28]

Condition 1 satisfied: If condition 1 above is satisfied, a designated beneficiary may generally receive a life annuity. However, the annuity is available only if the participant dies on or after the annuity starting date and does not die within 90 days after electing an earlier starting date. In addition, the beneficiary's periodic payment may not exceed a specified percentage of the periodic payment the participant was receiving. The participant determines the specified percentage from a table in the regulations, based on the difference between the participant's age and the beneficiary's age.[29]

> *Example 6: R*, an unmarried retiree, begins receiving QLAC payments of $2,000 per month on her 85th birthday. After *R*'s death, her son will receive monthly annuity payments for his lifetime. *R*'s son is age 53 on his birthday in the same calendar year *R* attains age 85. Thus, *R* is 32 years older than her son. Under the rules, minimum distribution requirements are satisfied only if the son's annuity payments are no more than $1,180 per month. *R* computes this amount by multiplying her $2,000 monthly payments by 59% (the percentage from the table that applies to an age difference of 32 years). If the premium for an annuity contract that would pay those amounts exceeds the QLAC dollar or percentage limit, the annuity payments must be proportionately reduced to produce a lower premium that satisfies the limits.

Condition 2 satisfied: A QLAC may also provide a life annuity to a designated beneficiary if condition 2 above is satisfied (i.e., timely irrevocable beneficiary selection). However, if the participant dies on or after his or her annuity starting date, the continuing periodic payment to the beneficiary may not exceed a specified percentage of the periodic payment the participant was receiving.[30]

If, instead, the participant dies before his or her annuity starting date, payments to the beneficiary must start by the last day of the year following the participant's death. The periodic payment to the beneficiary may not exceed a specified percentage of the hypothetical periodic payment the participant would have received had he or she survived and elected to commence payments on the beneficiary's actual annuity starting date.[31]

Whether the annuity under condition 2 starts before or after the participant's death, the specified percentage referred to above is based on the difference between the participant's age and the age of the designated beneficiary. However, the percentage for condition 2 is smaller than it is for condition 1 and is derived from a different IRS table.[32]

> *Example 7:* A plan purchases a QLAC for an unmarried retiree, *R*, in the calendar year she attains age 69. *R* irrevocably selects her brother, who will be age 62 on his birthday in the same calendar year, as her sole beneficiary. Thus, *R* and her brother are seven years apart in age.
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> Under the QLAC, *R* is entitled to receive payments of $2,000 per month starting at age 85. After her death, her brother will receive monthly payments for his lifetime whether or not *R* dies before or after her annuity starting date.

Death on or after the retiree's annuity starting date: Assume the unmarried retiree dies at age 88, after her annuity starting date. Then, minimum distributions must continue to the retiree's brother for his lifetime. However, the brother's annuity payments may be no more than $1,140 per month, computed by multiplying the $2,000 per month payments to the retiree by 57% (the percentage applicable to a seven-year age difference).

Death before the retiree's annuity starting date: Alternatively, assume the unmarried retiree dies at age 80, before her annuity starting date. Then, minimum distributions to the retiree's brother must start before the end of the year following the retiree's death, and must be appropriately reduced as follows.

The QLAC issuer determines that the retiree would have been paid $1,500 per month if she had been entitled to annuity payments starting on the date payments commence to her brother. The brother's annuity payments may be no more than $855 per month. This limitation is computed by multiplying the assumed payment to the retiree of $1,500 per month by 57% (the percentage attributable to a seven-year age difference).

Accommodating the premium limits: If the premium required to purchase the above-described contract exceeds the QLAC dollar or percentage limit, annuity payments to the retiree and beneficiary must be proportionately reduced to produce a lower premium that satisfies the limits.

28. Sec. 401(a)(9)(C)(i)(I); Regs. Secs. 1.401(a)(9)-2, Q&A 2(a), and 1.408-8, Q&A 3; Regs. Sec. 1.401(a)(9)-6, Q&As 17(c)(2)(iii), (iv), and (v).
29. Regs. Sec. 1.401(a)(9)-6, Q&A 2(c), and Q&As 17(c)(2)(i), (2)(iii)(A), and (2)(iv).
30. Regs. Sec. 1.401(a)(9)-6, Q&As 17(c)(2)(i), (2)(iii)(B), and (2)(v).
31. Regs. Sec. 1.401(a)(9)-6, Q&As 17(c)(2)(ii), (2)(iii)(B), and (2)(v). The contract must provide a way to determine the amount of the annuity payment the participant would have hypothetically received if, for example, the spouse's annuity starting date occurred before the earliest starting date available to the participant (Regs. Sec. 1.401(a)(9)-6, Q&A 17(c)(3)).
32. Regs. Secs. 1.401(a)(9)-6, Q&As 17(c)(2)(iii)(B) and (D).

Coordination With Required Spousal Annuity Rules

If a married participant in a qualified defined contribution plan elects to use any portion of his or her account balance for a life annuity, the plan must instead substitute specific types of spousal annuities.[33] These spousal annuity requirements generally apply at the time the participant elects to invest a plan amount in a life annuity, even though the start of the annuity is deferred. Specifically, the spousal annuity requirements apply if the life annuity payments are based on actuarial assumptions (e.g., interest and mortality assumptions) determined as of the time of the election.[34]

These overriding spousal annuity requirements apply to the portion of plan benefits a participant uses to purchase a QLAC.[35] The tax law requires the plan to pay that portion of the benefits to the participant and surviving spouse for their lives as a qualified joint and survivor annuity (QJSA).[36] If, instead, the participant dies before payments begin, the plan must pay at least one-half of the benefits to the surviving spouse for life as a qualified preretirement survivor annuity (QPSA).[37]

Unfortunately, requirements for QJSAs or QPSAs may conflict with the actual provisions of a QLAC. If so, the participant may resolve the conflict by waiving the QJSA or QPSA requirements with the consent of his or her spouse.[38] However, a waiver should not be necessary if the QLAC provisions are consistent with QJSA or QPSA requirements. Then, the QLAC should itself qualify as a QJSA or QPSA.

QJSAs: A QJSA is defined as an annuity payable to a participant for the participant's lifetime and, after the participant's death, to his or her spouse for the spouse's lifetime.[39] The periodic annuity payment to the surviving spouse must be from 50% to 100% of the payment to the participant during his or her life.[40] A QLAC will qualify as a QJSA if (1) the surviving spouse is the sole beneficiary and (2) the periodic payment to the surviving spouse is from 50% to 100% of the payment to the participant before the participant's death.

If a purchased QLAC does not qualify as a QJSA, the participant has 180 days immediately preceding the annuity starting date to waive the QJSA with the consent of his or her spouse.[41] However, before purchasing a nonconforming QLAC, the participant should get assurance that his or her spouse will consent to waive the QJSA requirement and will not later revoke that consent.[42]

QPSAs: A QPSA under a defined contribution plan is a life annuity

payable to the surviving spouse of a participant who dies before his or her annuity starting date. The QPSA must have a minimum present value equal to at least 50% of the nonforfeitable balance of the participant's account as of his or her death. Thus, a QLAC would ordinarily qualify as a QPSA if the surviving spouse is the sole beneficiary.[43] However, if it is anticipated that a QLAC might not qualify, the participant may waive the QPSA with his or her spouse's consent.[44] Again, the participant would want assurance that the spouse cannot or will not revoke the consent.[45]

Separate Shares for QLAC Beneficiaries

If a QLAC has more than one designated beneficiary, the participant or beneficiaries may divide the annuity into separate accounts, one for each

33. Secs. 401(a)(11)(A), 417(b), and 417(c); 29 U.S.C. §§1055(a), (d), and (e). Note that Sec. 403(b) plans may be subject to spousal annuity requirements under the regulatory provisions of ERISA, even though spousal annuities are not required by the Internal Revenue Code. However, spousal annuity requirements do not apply to qualified governmental plans, qualified church plans, and certain Sec. 403(b) plans with minimal employer involvement (Sec. 401(a) (last sentence); Secs. 411(e)(1), 414(d), and 414(e); 29 U.S.C. §§1003(b)(1)–(2); 29 C.F.R. §2510.3-2(f)).
34. Rev. Rul. 2012-3.
35. A QLAC is generally treated as a separate account for purposes of applying RMD rules and required spousal annuity rules (Regs. Sec. 1.401(a)(9)-5, Q&A 3(d); Regs. Sec. 1.401(a)(9)-8, Q&A 2(a)(3); Regs. Sec. 1.401(a)-20, Q&A 4).
36. Sec. 417(b); 29 U.S.C. §1055(d).
37. Secs. 401(a)(11)(A), 417(b), and 417(c); 29 U.S.C. §§1055(a), (d), and (e).
38. Secs. 417(a)(1)(A)(i) and (a)(2)(A)(i); Regs. Sec. 1.401(a)-20, Q&A 31.
39. Sec. 417(b); 29 U.S.C. §1055(d).
40. Sec. 417(b)(1); 29 U.S.C. §1055(d)(1).
41. Secs. 417(a)(1)(A)(i), (2)(A)(i), and (6)(A); Regs. Sec. 1.401(a)-20, Q&A 31.
42. Whether the spouse may revoke his or her consent to a waiver depends on the terms of the plan (Regs. Sec. 1.401(a)-20, Q&A 30).
43. Sec. 417(c)(2); 29 U.S.C. §1055(e)(2). Note that, under separate accounting rules, segregated QLAC funds will generally be treated as a separate account for this purpose. Regs. Sec. 1.401(a)(9)-5, Q&A 3(d); Regs. Sec. 1.401(a)(9)-8, Q&A 2(a)(3); Regs. Sec. 1.401(a)-20, Q&A 4; Rev. Rul. 2012-3.
44. Secs. 417(a)(1)(A)(i) and (a)(6); 29 U.S.C. §§1055(c)(1)(A)(i) and (e)(7); Regs. Sec. 1.401(a)-20, Q&A 33(b).
45. Whether the spouse may revoke his or her consent to a waiver depends on the terms of the plan (Regs. Sec. 1.401(a)-20, Q&A 30).

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beneficiary.[46] With separate accounts, the life annuities of the beneficiaries are more easily defined. Furthermore, a surviving spouse may receive a periodic payment equal to 100% of the periodic amount the account was required to pay to the participant,[47] even though payments to the other beneficiaries must be substantially reduced.[48]

Planning With Ordinary Rollovers

In some situations, it may be possible to use an ordinary tax-free rollover to effectively increase the 25% premium limitation to a higher percentage.

> ***Example 8:*** On a qualified plan's Dec. 31, 2015, valuation date, *R*, a retiree, has an account balance in the plan of $340,000 that includes no QLACs. *R* has no other retirement plan funds or IRAs. On Jan. 2, 2016, *R* directs his plan to purchase a QLAC for a premium of $85,000. The premium satisfies the $125,000 and 25% limitation on QLAC premiums. Immediately thereafter, *R* rolls over the remaining IRA balance of $255,000 to a traditional IRA.
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> On Dec. 31, 2016, the IRA account balance has increased to $280,000. On Jan. 2, 2017, *R* directs his IRA to purchase a QLAC for a premium of $40,000. The premium satisfies the 25% limitation because the $40,000 premium is less than 25% of the $280,000 IRA balance (i.e., less than $70,000). In addition, the premium satisfies the $125,000 limitation because the plan and the IRA have paid total QLAC premiums of exactly $125,000 ($85,000 paid by the plan and $40,000 paid by the IRA). Thus, *R* has invested 37% of his original retirement funds in QLACs (total QLAC premiums of $125,000 divided by the original $340,000 balance of his qualified plan).

Although planning with rollovers appears to satisfy the requirements of the regulations, it is always possible the IRS would contest this strategy. Note also that the regulations shed little light on the treatment of rollovers of QLACs.[49]

Planning With Roth Conversions and Rollovers

A retiree may avoid taking RMDs during his or her lifetime by rolling over funds of a plan or IRA into a Roth IRA.[50] However, the retiree must generally pay tax on the rollover.[51] An acceptable and less tax-costly alternative might be to combine the purchase of a QLAC with a Roth rollover.

> ***Example 9:*** On an IRA's Dec. 31, 2015, valuation date, *R*, a 70-year-old retiree, has an IRA account balance of $340,000 that includes no QLACs, and he has no other IRAs or retirement plan funds. On Jan. 2, 2016, *R* directs his IRA to purchase a QLAC for a premium of $85,000. The premium satisfies the $125,000 and 25% limitations on QLAC premiums. Immediately thereafter, *R* rolls over the remaining IRA balance of $255,000 to a Roth IRA.
>
> *R* has achieved substantial deferral. The Roth IRA is not required to make minimum distributions during the retiree's lifetime. The QLAC, the IRA's only asset, is not required to make minimum distributions until *R* reaches age 85. Of course, the QLAC deferral is not quite as good as the more complete Roth deferral. But *R* has avoided paying tax on the $85,000 he would have rolled over to the Roth IRA if he had not used the $85,000 for the QLAC premium.

Note that an annuity contract held by a Roth IRA cannot qualify as a QLAC. Therefore, if a QLAC is rolled over to a Roth IRA, it ceases to be a QLAC. Fortunately, though, the disqualified QLAC does not enter into the calculation of the dollar and percentage limitations on future QLAC premiums.[52] It is nevertheless difficult to think of a situation in which the rollover of a QLAC to a Roth IRA would be beneficial.

Conclusion

People in the United States are living longer and longer lives after they retire. QLACs are great financial tools to help retirees avoid running out of money by depleting their savings many years before they die. QLACs also enable taxpayers to increase their tax deferral by delaying annuity payments until they are 85 years old and allow taxpayers to exclude the value of the QLACs from the computation of RMDs. Because QLACs are going to be an important part of retirement planning, practitioners need to familiarize themselves with these rules. ■

Contributor

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46. Regs. Sec. 1.401(a)(9)-6, Q&A 17(c)(5); Regs. Sec. 1.401(a)(9)-8, Q&A 2(a).
47. Regs. Sec. 1.401(a)(9)-6, Q&A 17(c)(1).
48. Regs. Sec. 1.401(a)(9)-6, Q&A 17(c)(2).
49. The regulations do provide that, if a QLAC is rolled over from a plan to an IRA before the required beginning date under the plan, the retiree has until the end of the year following the rollover to irrevocably select a nonspousal beneficiary (Regs. Sec. 1.408-8, Q&A 12(d)).
50. Sec. 408A(c)(5).
51. Sec. 408A(d)(3)(A)(i).
52. Regs. Sec. 1.401(a)(9)-6, Q&A 17(d)(3)(ii); Regs. Sec. 1.408-8, Q&A 12(e); Regs. Sec. 1.408A-6, Q&A 14(d).