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New IRS and Treasury Rules Allow for Delayed Retirement Plan Annuities

In response to growing concerns about individuals' outliving their retirement savings, the IRS and Treasury recently issued final regulations regarding the use of qualifying longevity annuity contracts ("QLACs") as part of a tax-qualified defined contribution plan, Section 403(b) plan, or eligible governmental plan under Section 457(b).[1] The regulations are an effort to enhance retirement security and preserve individuals' lifetime income.

Generally, a QLAC is a lifetime annuity contract purchased from an insurance company that begins at an advanced age and satisfies certain specific requirements. The regulations set forth the requirements and revise prior regulations governing required minimum distributions ("RMDs") from tax-qualified defined contribution plans, Section 403(b) plans, and Section 457(b) governmental plans.

The Internal Revenue Code's RMD rules provide that an individual's retirement plan benefit must begin to be withdrawn no later than his or her "required beginning date" [*i.e.*, April 1 of the year following the year in which the individual either turns age 70½ or ultimately retires (whichever is later) or, for an individual who has an interest of 5% or more in a company sponsoring an applicable plan, the April 1 immediately following the year in which such individual attains age 70½]. To allow annuities to start at a later date, the new QLAC regulations create an exception to the RMD rules for applicable plans.

What are the requirements for a QLAC?

A QLAC is subject to all of the following requirements:

- For an individual, the premiums paid on all annuity contracts purchased for his or her benefit cannot exceed the lesser of: (1) $125,000 (as adjusted for inflation) minus any premiums already paid on such contract or any other contract under any other plan that is intended to serve as a QLAC; or (2) twenty-five percent (25%) of the individual's account balance under each plan, minus any premiums already paid on such contract or any other contract under that plan that is intended to serve as a QLAC. The annual aggregate dollar limit of $125,000 applies to the individual across all plans and IRAs in which the individual has an interest. The twenty-five percent (25%) limit applies only with respect to each plan individually.

- There can be no acceleration, commutation, cash surrender right or similar feature included as part of the annuity.

- The annuity cannot be a variable annuity, indexed annuity or similar arrangement.

- The annuity contract when issued (or any rider or endorsement thereto) must expressly state that it is intended to be a QLAC.

[1] The new QLAC rules also apply to individual retirement accounts ("IRAs"). How these rules apply to IRAs is beyond the scope of this Alert.

- Distributions must begin no later than the first day of the month next following the individual's 85th birthday.

Are there any death benefits available under a QLAC?

The new regulations provide that when the individual dies, either before or after commencement of payments from the QLAC, a single life annuity will be paid to either the individual's surviving spouse or designated beneficiary up to a particular amount specified in the regulations. Alternatively, the surviving spouse or designated beneficiary can elect to receive his or her death benefit in a single lump sum representing a return of the premiums paid but not yet distributed under the QLAC.

What should a plan sponsor do now?

The inclusion of a QLAC as a retirement plan feature is entirely discretionary. A plan sponsor should determine whether or not a QLAC is a retirement plan benefit worth pursuing for its employees and plan participants.

If you have any questions concerning QLACs and how they may affect your retirement plan, or if you would like assistance in reviewing plan documents or drafting a plan amendment in order to implement a QLAC, please contact us.

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This edition of the Employee Benefits & Executive Compensation Alert highlights recent guidance published by the IRS regarding qualifying longevity annuity contracts. The Alert was written by Devin M. Karas, a member of the Employee Benefits & Pension Practice Area at Reid and Riege, P.C. The Practice Area works closely with clients to design and draft tax-qualified and nonqualified retirement plans. For information or additional copies of this Alert, or to be placed on our mailing list, please contact Devin (tel. 860-240-1063) (e-mail dkaras@rrlawpc.com) or another member of the Practice Area, John J. Jacobson, Chair (tel. 860-240-1006) (e-mail jjacobson@rrlawpc.com), John V. Galiette (tel. 860-240-1009) (e-mail jgaliette@rrlawpc.com), Ronald J. Koniuta (tel. 860-240-1034) (e-mail rkoniuta@rrlawpc.com), or Erek M. Sharp (tel. 860-240-1074) (e-mail esharp@rrlawpc.com), or the Reid and Riege attorney with whom you regularly work.

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