INVESTMENT COMPANY INSTITUTE

MEMO# 28252

July 9, 2014

Final Regulations on RMD Exemption for Longevity Insurance

[28252]

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TO:

PENSION MEMBERS No. 29-14
BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 30-14
TRANSFER AGENT ADVISORY COMMITTEE No. 43-14
OPERATIONS COMMITTEE No. 35-14

RE:

FINAL REGULATIONS ON RMD EXEMPTION FOR LONGEVITY INSURANCE

The IRS has published final regulations regarding the purchase of qualifying longevity annuity contracts (QLACs) within defined contribution plans and IRAs. [1] The final regulations, which are similar to the 2012 proposed regulations, [2] exempt the value of a QLAC purchased under a defined contribution plan (including a 401(k), 403(b) or governmental 457(b) plan) or IRA from the required minimum distribution (RMD) rules. The purpose of the exclusion is to encourage use of longevity annuities, which begin at a later age (such as age 85), as part of a retirement income strategy. The regulations are effective on July 2, 2014 and apply to contracts purchased on or after that date.

The exclusion does not apply to Roth IRAs because no RMDs are required during a Roth IRA owner's life.

Definition of QLAC

Under the final regulation, a QLAC is an annuity contract purchased from an insurance company that meets certain requirements, including premium limitations described in detail below. A QLAC's specified annuity starting date must be no later than the first day of the month next following the 85th anniversary of the employee's birth (although a QLAC could permit a participant to elect an earlier start date than the one specified). [3] Once distributions from the QLAC begin, the distributions must otherwise satisfy applicable RMD rules under 1.401(a)(9)-6 (regarding defined benefit plans and annuity contracts). Qualifying contracts cannot offer any commutation benefit, cash surrender value, or similar feature. Additionally, a QLAC cannot be a variable annuity, indexed annuity, or similar contract, except to the extent permitted in by the IRS in revenue rulings or other guidance. (Certain contracts that pay dividends or provide for a cost-of-living adjustment are not considered "similar contracts" to variable or indexed contracts and therefore are permitted.)

The only death benefits permitted under a QLAC are a life annuity, meeting specified criteria, payable to a designated beneficiary (spouse or non-spouse), or a return of premium payment (i.e., the excess of the premium payment(s) over the amount actually paid to the employee (and any designated beneficiary) under the QLAC). Under the proposed regulation, a return of premium feature would not have been a permissible death benefit under a QLAC, but in response to comments from the insurance industry, the final regulation expanded the types of permissible death benefits to include return of premium payments (subject to meeting certain requirements).

The value of an annuity contract meeting these specified conditions is excluded from the plan or IRA account balance for purposes of calculating RMDs.

Limitation on Premiums

Under the final regulation, the qualifying premium amount is limited to the lesser of 25 percent of the account balance or $125,000 (up from $100,000 in the proposal). [4] In applying these limits, other premium amounts previously paid by the individual for a QLAC must be taken into account. Specifically, the $125,000 limitation would have to be reduced by premiums paid for the same QLAC or any other QLAC under the plan or IRA, or under any other plan or IRA. For plans (including 403(b) plans), the 25 percent limitation would apply on an individual plan basis, and the amount under the 25 percent limitation would have to be reduced for premiums paid for the same QLAC or any other QLAC under the particular plan. [5] For IRAs, the 25 percent limitation would apply to the IRA owner's aggregate (non-Roth) IRA balances (held as an IRA owner), and the amount under the 25 percent limitation would have to be reduced for premiums paid for the same QLAC or any other QLAC under any of the IRA-owner's non-Roth IRAs. [6]

Under the proposal, any amount exceeding these amount limitations would have caused the contract to fail to be a QLAC. The final rules permit individuals who inadvertently exceed the 25 percent or $125,000 limits on premium payments to correct the excess without disqualifying the entire annuity purchase. Excess premiums must be returned to the non-QLAC portion of the account by the end of the calendar year following the calendar year in which the excess premium was originally paid.

As under the proposal, plan administrators may rely on an employee's representation [7] as to the amount of any other QLAC premiums paid, unless the plan administrator has actual knowledge to the contrary, or unless the premiums are paid under a plan sponsored by that employer. Similarly, IRA trustees and custodians may rely on the IRA owner's representations as to the amount of any other QLAC premiums paid outside of that IRA and the amount of the IRA owner's aggregate account balances outside of that IRA, unless the trustee or custodian has actual knowledge to the contrary.

Disclosure requirements

The proposed regulations provided that a contract is not a QLAC unless it states, when issued, that it is intended to be one. In response to comments, the final rules allow inclusion of such a statement in an insurance certificate, rider, or endorsement relating to a contract, with a special transition period for contracts issued before January 1, 2016.

To facilitate compliance with the premium limitations and other criteria for QLACs, the rule imposes annual reporting and disclosure requirements on the issuer of a QLAC, similar to the annual Form 5498 (IRA Contribution Information) requirement for IRAs. The report to be filed with the IRS will be required to identify that the contract is intended to be a QLAC and to contain:

- identifying and contact information for the contract issuer;
- identifying information for the individual in whose name the contract was purchased;
- identifying information about the plan/plan sponsor (if not an IRA);
- the scheduled annuity starting date, periodic amount payable on that date, and whether that date can be accelerated;
- the amount of premiums paid for the contract for the calendar year (and date of each payment) and the total amount of all premiums paid for the contract through the end of the calendar year; and
- the fair market value of the QLAC as of the close of the calendar year.

The IRS will prescribe the applicable form and instructions, including the filing deadline. Issuers must provide a copy of the form or otherwise provide this required information to the participant or IRA owner by January 31 following the calendar year for which the report is required. The proposal would have required an initial disclosure about the QLAC at the time of purchase, but this requirement was eliminated in the final rule in light of existing disclosure practices that take into account state law and ERISA disclosure requirements (such as the participant disclosure requirements under ERISA section 404(a)).

Elena Barone Chism
Associate Counsel

endnotes

[1] A copy of the final regulations is available here: http://www.gpo.gov/fdsys/pkg/FR-2014-07-02/pdf/2014-15524.pdf and a press release is available here: http://www.treasury.gov/press-center/press-releases/Pages/jl2448.aspx.

[2] See Memorandum to Pension Members No. 10-12 [25918], dated February 16, 2012. For a copy of the Institute’s comment letter on the proposal, see Memorandum to Pension Members No. 21-12 [26150], dated May 7, 2012.

[3] The maximum age at commencement may be adjusted by the IRS to reflect changes in mortality.

[4] Beginning in 2015, the $125,000 limitation would be adjusted for inflation by multiples of $10,000.

[5] The 25 percent limitation is applied to the participant’s account balance as of the last valuation date preceding the date of the premium payment, increased for contributions allocated to the account after the valuation date and before the premium payment and decreased for distributions made during that same period.

[6] For IRAs, the 25 percent limitation is applied to the owner’s aggregate non-Roth IRA

balances as of December 31 of the calendar year immediately preceding the calendar year in which a premium is paid.

[7] The representation must be made in writing unless otherwise specified by the IRS.
