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**BLOG**

# IRS Issues Final Regulations Governing the Use of Longevity Annuity Contracts in Defined Contribution Plans

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On July 1, 2014, the IRS issued final regulations regarding the use of longevity annuity contracts in tax-qualified defined contribution plans (the “Regulations”). The Regulations also apply to individual retirement accounts under Section 408 of the Internal Revenue Code (the “Code”), Code Section 403(b) plans, and Code Section 457(b) governmental plans. The Regulations permit the purchase of qualifying longevity annuity contracts in these types of plans, provided certain requirements are met.

The Regulations are the end result of what began as a 2010 request for information by the DOL and IRS regarding lifetime income options for retirement plan participants. One issue that particularly interested the DOL and IRS was how the required minimum distributions (“RMD”) rules affected defined contribution plan sponsors’ interest in offering lifetime income products (and participants’ interest in using those products). They wanted to know whether changes to the RMD rules could encourage these products to be offered in defined contribution plans. Through its request for information, the DOL and IRS learned that the RMD rules were viewed negatively with respect to annuity contracts because, generally, the value of an annuity contract held under a defined contribution plan that has not yet been “annuitized” is included in the portion of the participant’s account balance that is used to determine the participant’s RMDs. Under the Regulations, the value of an annuity contract that is a “qualifying longevity annuity contract,” or “QLAC” is excluded from the account balance used to determine RMDs. In short, the Regulations provide an exception to the RMD rules for assets in QLACs.

To be a QLAC, the Regulations provide that an annuity contract must satisfy certain requirements. Among other things: (i) distributions under a QLAC must begin by the first day of the month following the employee’s attainment of age 85; (ii) premium payments for the QLAC must not exceed the lesser of $125,000 or 25% of the individual’s benefit (the IRS imposes these caps to limit undue deferrals of distributions); (iii) a QLAC cannot be a variable contract under Code Section 817, an indexed contract, or any similar contract; (iv) a QLAC must state, when issued, that is it intended to be a QLAC; (v) a QLAC issuer must file annual reports with the IRS and provide statements to plan participants; and (vi) QLACs are not permitted to make available any commutation benefit, cash surrender value, or similar feature.

The Regulations also allow QLACs to have certain features that plan participants will likely find attractive. For example, Return of Premium (“ROP”) is a feature that guarantees an additional payment to the participant’s

beneficiary in the event that the participant dies before receiving payments that equal at least the total premiums paid under the contract.

With the “waiver” of RMDs and other favorable features such as ROP, the Regulations will likely result in more 401(k) plans offering QLAC options in the near future.
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