Qualified Lifetime Annuity Contract (QLAC)

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What is a QLAC?

A **Qualified Longevity Annuity Contract (QLAC)** is a type of deferred income annuity that can be purchased using funds from a traditional IRA, 401(k), or similar retirement account (deferring income tax associated with RMDs on the amount funding the QLAC). A QLAC is designed to provide a guaranteed stream of income (subject to taxation) later in life, helping retirees manage longevity risk, or the risk of outliving retirement savings.

Key Features of QLACs

- **Income Deferral**: Payments from a QLAC begin at a later age (often around 75-85), ensuring a steady income stream later in life.
- **No Required Minimum Distributions (RMDs)**: QLACs are exempt from the RMD rules before annuity income payments start. This means you can avoid withdrawing from this portion of your retirement funds until income from the QLAC begins.
- **Contribution Limits**: QLAC contributions are limited by IRS rules, but they allow retirees to allocate a portion of their retirement savings to secure future income.

Secure Act Changes to QLACs

- The **SECURE Act (Setting Every Community Up for Retirement Enhancement Act)**, passed in 2019, and its update, **SECURE 2.0 Act**, which was passed in 2022, introduced significant changes to retirement plans, including QLACs. Below are the key differences in QLAC rules before and after the SECURE Act changes:

•**1. Contribution Limits:**

- **Before the SECURE Act**: QLAC contributions were capped at **25% of the total retirement account balance** or **$135,000** (increased periodically with inflation), whichever was less.
- **After the SECURE Act 2.0**: The SECURE Act **removed the 25% limit**, making it easier for retirees with large balances to allocate more to QLACs. The cap was also increased to **$200,000** (as of 2023), with further adjustments for inflation in the future.

Secure Act Changes to QLACs (continued)

•**2. Spousal Continuation:**

- **Before the SECURE Act**: There were some restrictions around spousal continuance, meaning it could be complex for spouses to inherit or continue receiving benefits under a QLAC.
- **After the SECURE Act**: The updated rule clarified that **spouses could continue QLACs** after the original owner's death, enhancing the flexibility and survivorship options.

QLAC Income Distribution Requirements (the tax man cometh)

- **Before the SECURE Act**: QLAC payments generally had to begin by age 85, giving a long deferral window but with clear cutoffs.
- **After the SECURE Act**: There were no significant changes in this area. The starting age for QLAC payouts remains flexible and typically occurs in later life (ages 75-85), based on the annuity contract's terms.

QLAC Payouts

- **Before the SECURE Act**: The funds placed in a QLAC were exempt from RMDs (Required Minimum Distributions) before the income payments began.
- **After the SECURE Act**: This provision remains unchanged. You don’t need to take RMDs from QLAC funds until the annuity starts paying out, making it a useful tool for delaying taxable distributions.

Summary of Secure Act Changes

- **Increased flexibility**: The removal of the 25% limit allows greater amounts of savings to be put into QLACs.
- **Larger cap**: The higher contribution limit of $200,000 (subject to adjustment for inflation) allows for more significant income later in retirement.
- **Better survivorship options**: Spouses have clearer pathways for inheriting and continuing QLACs, improving legacy planning.

Final Thoughts

QLACs are a special type of a deferred annuity designed to secure income (subject to taxes) in late retirement that is funded from an IRA or K401 balance.

The SECURE Act's changes have enhanced QLACs flexibility and utility, potentially making them a more attractive option for retirees looking to manage longevity risk and reduce required minimum distributions in earlier retirement years. **However, QLACs are annuities subject to the cost, inflexibilities, complexities and terms and conditions of the annuity contract.**

Final Thoughts

- While the primary feature of a QLAC is the deferral of annuity payments, there are specific rules around accessing or withdrawing the funds before those payments begin. Here’s how it works: No Withdrawals Before the QLAC Payments Begin.
- Once you fund a QLAC, you generally cannot withdraw or access the proceeds used to purchase the QLAC before the scheduled start date for the deferred payments. This means if your QLAC defers payments until age 85, you cannot withdraw any of the funds you used to purchase the QLAC until the payments begin.
- The IRS rules are strict about this to ensure that the QLAC meets the requirements for tax deferral and longevity insurance.

Final Thoughts

- Limited Death Benefits Many QLACs offer a return of premium death benefit. If the annuitant dies before the QLAC payments begin, the contract can provide that the unused premium (the original amount used to fund the QLAC) will be paid to a beneficiary, often as a lump sum. However, this feature must be selected when you purchase the QLAC.

- No Cash Surrender or Lump-Sum Withdrawals.
- QLACs are structured to avoid any early withdrawal options. Unlike some other types of annuities, QLACs do not allow you to cash out or take partial lump-sum withdrawals before the deferred annuity payments begin. This is part of the reason they qualify for the RMD exclusion under IRS rules.

Final Thoughts

- Once Payments Begin: Once the deferred QLAC payments start at age 85, the annuitant receives regular payments for life, ensuring a stream of income late in retirement. The amount of the payments depends on the initial premium, the length of the deferral period, and the annuity terms.
- In summary, while you cannot withdraw funds before the QLAC annuity payments start, QLACs offer tax advantages and the option to provide for a death benefit to a beneficiary.