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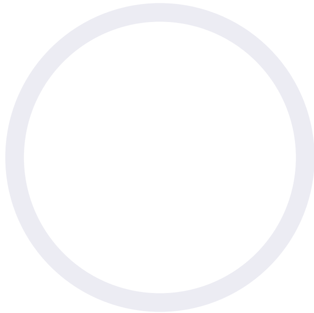

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SECURE 2.0 Opens the Door for Qualified Longevity Annuity Contracts (QLACs)

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The QLAC allows individuals to convert up to $200,000 of their IRA to a non-countable resource for Medicaid eligibility.

Last year, in a rare show of bipartisan action, the House and Senate passed a law intended to give Americans an incentive to save for retirement. The bill received over 400 votes in the House and over 80 in the Senate. The bill, dubbed SECURE 2.0, is a follow-up to the SECURE Act. Congressional leaders included SECURE 2.0 in the government funding bill signed by President Biden on December 29, 2022.

Many seniors fear outliving their resources. In 2012, the Department of Labor, the IRS, and the Department of the Treasury issued a Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans.[1] The IRS issues these final rules based on written submissions and public hearings.[2] Although these new rules apply to IRA accounts and all employer-sponsored plans such as 401k, 403b, or 457b plans, this article will focus on IRA accounts.

A qualified longevity annuity contract (QLAC) is an annuity purchased from an insurance company with a portion of the assets of the IRA. Before SECURE 2.0, the maximum premium for a QLAC could not exceed the lesser of 25% of the account balance or $125,000. The low premium cap severely limited the benefit of the QLAC. Fortunately, SECURE 2.0 removed the percent limitation and raised the maximum premium to $200,000, making QLACs a viable strategy.[3]

To understand the benefit of a QLAC, one must remember that an IRA funded with liquid investments uses the defined contribution plan distribution rules.[4] Any annuity purchased within an IRA uses the defined benefit rules.[5] If an IRA owns liquid assets and a QLAC, determining the required minimum distribution (RMD) is a two-step process. The Uniform Lifetime Table determines the RMD for the liquid asset component, while the RMD for the QLAC is [illegible] from the QLAC have not begun, there is only an RMD based on the liquid assets.

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A QLAC can be for the account owner's life or the joint life of a designated beneficiary. QLACs must have an annuity starting date no later than the first day of the month following the 85th anniversary of the employee's birth.

To be a QLAC, besides the premium limitation, the annuity must meet the following requirements:[6]

1. The contract provides that distributions under the contract must commence with a specified annuity starting date that is no later than the first day of the month following the 85th anniversary of the employee's birth.
2. The contract provides that after distributions under the contract commence, those distributions must satisfy the requirements of IRC § 401(a)(9).
3. The contract does not make available any commutation benefit, cash surrender right, or other similar feature.
4. It provides no benefits under the contract after the death of the employee.
5. When issued, the contract states the annuity contract intends to be a QLAC.
6. The contract is not a variable, indexed, or similar contract, although a cost of living adjustment is permitted.
7. The issuing insurance company must file annual reports on the QLAC to the IRS and copy participants.
8. A QLAC can be purchased before or after the account owner's Required Beginning Date (RBD) but is subject to the age 85 limitation.

On paper, the ability to increase IRA distributions upon attaining a predetermined age sounds attractive. Assuming a 6% return (an amount easily achieved in a tax-free IRA account under professional management) with RMDs commencing in 2023, the IRA account will increase in value until 2036, when the account holder is 86 years. It is at this point that the RMDs will decline. If the IRA purchased a QLAC at the time RMDs commence, the account holder would then receive payments from the QLAC in addition to their RMD.

The issue lies in the internal rate of return of the QLAC. Upon purchase, the rate of return of the QLAC will be affected by commissions and other administrative costs. The internal rate of return of a QLAC over the entire timeline of the QLAC must exceed the rate of return of the invested IRA assets.

Insurance companies can offer several optional riders heralded as benefits of a QLAC. The first is a cost of living adjustment similar to the one allowed in traditional IRA accounts.[7]

Another benefit is that a QLAC can offer a Return of Premium (ROP) option. The ROP guarantees that upon the account owner's death, the beneficiary receives the premium paid for the QLAC less the total annuity payments received by the account owner.[8] The ROP following the account holder's death must be distrib ... ar
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account holder's death is after the required beginning date. In that case, the

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beneficiary's ROP payment is a required minimum distribution to the beneficiary for the year in which paid and is not eligible for rollover.[9]

If a surviving spouse receiving a life annuity with an ROP dies, or after the death of a surviving spouse who has not yet commenced life annuity payments following the death of the account owner, the ROP payment must be distributed no later than the end of the calendar year following the calendar year in which the surviving spouse dies. If the surviving spouse's death is after the RBD of the surviving spouse, then the ROP payment is treated as a required minimum distribution for the year in which it is paid and is not eligible for rollover.[10]

A QLAC can provide for the joint life of the account holder and a designated beneficiary. The designated beneficiary may receive a life annuity in addition to the ROP option. If the sole beneficiary of the QLAC is a surviving spouse, the rules are different. If the account holder dies before or after the QLAC starting date, the surviving spouse can receive a life annuity equal to the amount the account holder would have received. The life annuity payable to the surviving spouse must commence no later than the date on which the QLAC payable to the account holder would have started under the contract if the account holder had not died.[11]

If the surviving spouse is not the sole beneficiary, the life annuity amount is equal to the payments to the account holder reduced by a percentage based on the age difference between the account holder and the beneficiary.[12] This schedule is contained in Reg. § 1.401(a) (9)-6 [Q&A-17(c) 1921] (1).

While a QLAC can reduce an individual's current RMD if not needed for current expenses, it can protect an IRA if the account owner requires nursing home care.

The Deficit Reduction Act of 2005 provided that the principal of an annuity is an available resource unless the annuity is irrevocable, actuarially sound, and annuity payments are level.[13] Simultaneously, annuities purchased in an IRA are exempt from these requirements.[14] This makes a QLAC a Medicaid-compliant annuity and is not an available resource.

However, a QLAC still must either name the state as the remainder beneficiary to the extent of the cost of medical assistance paid on behalf of the account holder, or the state as the secondary beneficiary after a community spouse or a minor or disabled child.[15]

This gives rise to a true conflict. IRC § 401(a)(9) and its regulations require that if there are multiple beneficiaries of an IRA account, the permissible payment period is determined using the age of the oldest joint beneficiary. For this purpose, only individuals have an age; a charity, estate, or state is treated as having no life expectancy. As a result, the entire balance of the IRA account must be distributed within five years after death.

When there is a surviving spouse and minor or disabled child, this does not present a problem. However, when the beneficiary is not one of the above, it presents what appears to be an irreconcilable conflict. If funds owed to the state do not exceed the IRA account balance, the state will choose the ROP option, which is an a[illegible]e IR[illegible] the state is repaid, w[illegible]ceive the proceeds of the IRA over five years or distribute the balance no later than

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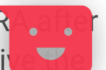

December 31 of the year following death as required under QLAC regulations? If the state completes its recovery before September 30 of the year following death, does the separate share rule apply, and the taint of the state as a beneficiary is removed?

Notwithstanding the state recovery issue, the QLAC allows individuals to convert up to $200,000 of their IRA to a non-countable resource for Medicaid eligibility.

1. 75 FR 5253
2. Internal Revenue Bulletin - July 21, 2014 - TD 9673
3. Reg. § 1.401(a)(9)-6, Q&A-17(b)
4. Reg. § 1.401(a)(9)-5
5. Reg. § 1.401(a)(9)-6
6. Reg. § 1.401(a)(9)-6, Q&A-17(a)
7. Reg. § 1.401(a)(9)-6 Q&A-14(b)
8. Reg. § 1.401(a)(9)-6, Q&A-17(c)(4)
9. Reg. § 1.401(a)(9)-6, Q&A-17(c)(4)(iii)(A)
10. Reg. § 1.401(a)(9)-6, Q&A-17(c)(4)(iii)(B)
11. Reg. § 1.401(a)(9)-6, Q&A-17(c)(1)
12. Reg. § 1.401(a)(9)-6, Q&A-17(c)(2)
13. 42 U.S.C.A. § 1396p(c)(G)(ii)
14. 42 U.S.C.A. § 1396p(c)(G)(i)
15. 42 U.S.C.A. § 1396p(c)(F)

About the Author
Stephen Silverberg, CELA, CAP, Fellow, AEP®, is nationally recognized as a leader in the areas of estate planning, estate administration, asset preservation planning, and elder law.

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