Want to Reduce Required Minimum Distributions and Extend Your Retirement Benefits?

Article Highlights:

- Required Minimum Distributions (RMDs)
- Qualified Longevity Annuity Contracts
- Reduced RMDs
- A Form of Longevity Insurance
- Delayed Taxes

If you are one of the boomer generation, and if you find that your required minimum distributions (RMDs) from qualified plans and IRAs are providing unneeded income (along with a high tax bill), or if you are afraid that the government's RMD requirements will leave too little in your retirement plan for your later years, you can use a qualified longevity annuity contract (QLAC) to reduce your RMDs and extend the life of your retirement distributions.

The government allows individuals to purchase QLACs with their retirement funds, thus reducing the value of those funds (subject to the RMD rules) and in turn reducing the funds' annual RMDs.

A QLAC is a deferred-income annuity that begins at an advanced age and that meets the stringent limitations included in the tax regulations. One benefit of a retirement-planning strategy involving QLACs is that they provide a form of longevity insurance, allowing taxpayers to use part of their retirement savings to buy an annuity that helps protect them from outliving their assets.

The tax-planning benefits of QLACs are twofold:

(1) Because the QLAC is purchased using funds from a qualified retirement plan or IRA, that plan's year-end balance (value) is lowered. This causes the RMDs for future years to be less than they otherwise would be, as the RMD is determined by dividing the account balance (from 12/31 of the prior year) by an annuity factor that is based on the retiree's age.

Example: Jack is age 74, and the annuity table lists his remaining distribution period as 23.8 years. The balance of his IRA account on 12/31/2016 is $400,000. Thus, his RMD for 2017 would be $16,807 ($400,000 / 23.8). However, if Jack had purchased a $100,000 QLAC with his IRA funds during 2016, his balance would have been $300,000, and his 2017 RMD would be $12,605 ($300,000 / 23.8). By purchasing the $100,000 QLAC, Jack would have reduced his RMD for 2016 by $4,202 ($16,807 – $12,605). This reduction would continue for all future years. Later, the $100,000 QLAC would provide retirement benefits, likely beginning when Jack reaches age 85.

(2) Tax on the annuity will be deferred until payments commence under the annuity contract.

A deferred-income annuity must meet a number of requirements to be treated as a QLAC, including the following:

Limitation on premiums – When buying a QLAC, a taxpayer can use up to the lesser of $125,000 or 25% of his or her total non-Roth IRA balances. The dollar limitation applies to the sum of the premiums paid on all QLAC contracts.

When distributions must commence – Distributions under a QLAC must commence by a specified annuity starting date, which is no later than the first day of the month after the taxpayer’s 85th birthday.

For additional details about how QLACs might fit into your retirement strategy, please give this office a call.