As more and more seniors look for ways to lower their taxes in retirement, QLACs are stepping into the spotlight.

Many seniors in the early phases of their retirement don’t need to tap into their traditional retirement accounts (IRAs/401ks). Unfortunately, they are forced to do so because of IRS Requirement Minimum Distributions rules. Note: The RMD age recently changed from 70.5 to 72.

When you reach your RMD age, you must take money out of your qualified plan each year. Be sure to clarify with your CPA or tax planner to which group you belong.

If you are in a similar situation and don’t need to take distributions, you may want to consider setting up a **Qualified Longevity Annuity**. The “qualified” part of the QLAC refers to the fact that this kind of annuity is purchased with “qualified” funds as defined by the IRS.

A QLAC uses a portion of a person’s RMD distributions to grow deferred until a certain age (85 maximum). QLACs are a type of longevity annuity.

A QLAC, which has the insurer taking on market and interest rate risk, is set up by transferring money from an existing IRA or 401(k) account to an insurance company annuity. A QLAC contract pays you a steady stream of Income later in life.

The longevity annuity “chassis” of a QLAC has been around for years. But what has changed is how the IRS treats longevity annuities within tax-deferred accounts. Current rules allow individuals to spend 25% of their retirement savings account or $135,000 (whichever is less) to purchase a QLAC.

In 2014, the Treasury Department relaxed RMD rules a bit to encourage Americans to prepare for retirement. These new rules let you buy a QLAC with your IRA and not include the value of the QLAC when you calculate your RMD.

How does a Qualified Longevity Annuity Work?

A Qualified Longevity Annuity is an annuity into which you pay a lump sum of money. At a future date specified on your contract, you begin receiving guaranteed monthly Income for as long as you live.

A longevity annuity appeals to many because the stock market and interest rate risk transfers to the insurance company. The insurance company tells you exactly how much income you will get in the future when you purchase the annuity. This future income amount is guaranteed!

With a QLAC, you get tax-advantaged income security that starts in your old age for an attractive price.

By owning a QLAC, you may be able to increase the amount withdrawn from your savings in the early retirement phase by as much as 30% because the annuity will give you predictable, guaranteed income later.

Many retirees purchase QLACs because of their tax advantages. However, they have other benefits, too. QLACs require only one upfront payment and don’t have annual fees. They are one of the easier-to-understand, straightforward, and transparent financial products.

How can a QLAC help reduce taxes?

A QLAC can help you retain more of your money in retirement by reducing your tax burden.

Let’s say you had a traditional IRA and invested the maximum allowable $135,000 into a QLAC with a payment start date of age 80. If you had not purchased a QLAC, your $135,000 would grow in value. When you reached your RMD age, you would have to withdraw your first RMD, which is fully taxable as income.

Having a QLAC, you are permitted to omit that $135,000 from your RMD calculations. The tax savings from not having to take your RMDs for nearly ten years could add up to huge savings. To understand how this might help your unique situation, you will need to consult a tax expert who understands the inner workings of QLAC products.

What are some pros and cons of QLACs?

QLACs, as mentioned before, allow you to defer mandatory distributions up to age 85, which could add up to significant tax savings. Also, you can retain tax advantages because you purchase a QLAC with qualified funds.

A QLAC can provide an increase in your financial security and well-being. You will have the kind of contractually guaranteed, predictable stream of income that you only get with annuity products.

Properly designed QLACs can also help you cover long-term care expenses and provide protection for your spouse so that if you die before they do, they will continue to receive income.

Converting as little as 15% of your 401(k) balance to a QLAC when you retire can boost your retirement readiness in a meaningful way.

The downsides of QLACs

QLACs have many positive benefits, but they are not for everyone. If you enjoy a lot of hands-on control over your money, having a QLAC might not work well for you. That’s because you relinquish short-term control over your money to get guaranteed lifetime income with an annuity.

Like many other financial products, QLACs require a degree of trust in the company providing the product. After all, payouts for annuities are contingent upon the claims-paying ability of the annuity company who issues them. You must do your research and only select companies with strong ratings and positive client feedback.

You should only purchase a QLAC after consulting a safe money and income specialist. Even if you currently have a financial advisor, he or she may not understand the nuances of a QLAC, especially if you choose to use a QLAC in more complicated financial planning strategies, such as “laddering.” If your current advisor cannot explain QLACs to you, seek advice from a qualified expert.

Lawrence Castillo is a member of *Syndicated Columnists*, a national organization committed to a fully transparent approach to money management.

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