Johnston Investment Counsel

Trusted Fiduciaries & Fee-Only Advisors

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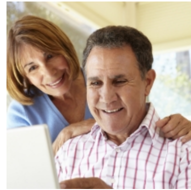
Qualified Longevity Annuity: Income Protection for a Long Life



As life expectancies increase, longevity risk--the risk of outliving retirement savings--is a concern for a growing number of people. In response, recent federal regulations created qualified longevity annuity contracts (QLACs), which are accessible through employer-sponsored plans, such as 401(k)s and IRAs.

What is a QLAC?

A QLAC is a type of longevity annuity that is held in an employer-sponsored plan such as a 401(k), 457(b), or 403(b) plan, and in IRAs. The premium paid to a QLAC is held for a number of years until distributions begin later in life, such as age 80. There are specific requirements and restrictions that apply to QLACs, including:

- The QLAC must generally be payable over the retiree's lifetime or over the lifetimes of the retiree and a beneficiary, and the interval between payments can be no longer than one year
- The QLAC must provide that payments begin no later than the first day of the month following the participant's 85th birthday, although an earlier starting age may be selected
- No more than 25% of any individual plan account balance may be allocated to a QLAC (including the value of the QLAC), and the value of all the retiree's IRAs are treated as a single plan for purposes of applying the percentage limit
- The total amount of all QLAC premiums paid by all retirement plans and IRAs over the participant's lifetime may not exceed $125,000, adjusted for cost-of-living increases, although inadvertent overfunding can be remedied if done in a timely manner
- QLACs may not include "cash out" or surrender provisions, and a QLAC may not be a variable annuity or an indexed annuity, nor can a QLAC be held in a defined benefit (pension) plan, Roth IRA, or Roth 401(k)

Caution: *Annuity guarantees are subject to the claims-paying ability and financial strength of the annuity issuer. Annuities have contract limitations, exclusions, fees, expenses, termination provisions, and terms for keeping them in force. Investors may sacrifice the opportunity for higher returns that might be available in the financial markets, and inflation could reduce the future purchasing power of their annuity payouts.*

Potential QLAC benefits

- QLAC balances during deferral are not included in calculating RMDs, reducing the amount of required distributions and the income tax bite associated with those distributions
- The amount and starting date of future QLAC distributions is predetermined, allowing a retiree to more accurately calculate how long income from retirement savings may need to last
- A QLAC may provide cost-of-living adjustments to potentially increase the income stream
- A QLAC death benefit may include a return of premium

Potential QLAC drawbacks

- QLACs are not liquid, have no cash surrender value, are generally irrevocable, and are not subject to growth potential during deferral years
- Retirement plan sponsors may not allow for the purchase of a QLAC within their retirement plan
- Funding a QLAC with a portion of a retirement account reduces the account balance available to provide income during the years before the QLAC distributions begin
- No payments will be made to a QLAC beneficiary if the annuitant dies before the payment start date, unless the contract owner has purchased an optional death benefit

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Prepaid Funeral Arrangements Can Have Grave Consequences

Avoiding Probate: Is It Worth It?

What is the Roth 401(k) five-year rule?

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Prepaid Funeral Arrangements Can Have Grave Consequences

Possible long-term care benefit

Irrevocable funeral trusts may also help you qualify for long-term care benefits through Medicaid. These trusts may be funded with assets that would otherwise be countable resources for Medicaid. Trust assets, including life insurance death benefits, are not countable resources when trying to qualify for long-term care benefits through Medicaid. And you can fund the funeral trust right before applying for benefits--there's no "look-back" period for these transfers. The legal expense to create an irrevocable funeral trust (IFT) is typically paid by the insurance company, which acts as the Trustee. There is typically no expense to the insured party to create the IFT other than the one-time cost of the insurance. Almost all states impose a limit on the amount of money that can be placed in a funeral trust. Not all funeral trusts are considered to be Medicaid-exempt assets. Consult with your estate planning attorney for help with your individual circumstances.

An important part of estate planning involves consideration of funeral or memorial arrangements, including paying for some or all of the costs in advance. Planning ahead not only spares your survivors from the stress of making these decisions, but prepaying for your services relieves your survivors from the burden of worrying about money during an otherwise difficult time.

Prepaid agreement

One way to prepay your funeral is by entering into a pre-need agreement with a funeral home of your choice. The funeral home may agree to "lock in" costs for future funeral or burial services at an agreed-upon price. This is often done through a trust or other arrangement that you can fund with cash, bonds, or life insurance. At your death, the funds are disbursed to pay for your funeral according to the terms of the agreement.

But before entering into a prepaid arrangement, you may want to get answers to the following questions:

- What happens to the funds you've prepaid? How are they held? Do they earn interest? Are they safe?
- What happens if the funeral home goes out of business? What protections, if any, do you have that your funds will be available when needed?
- Can you cancel the agreement and, if so, are you able to receive a refund?
- If you move, can your funds be transferred to another funeral home? Will the same terms apply? Is there a fee or cost to transfer your funds to another funeral home?

The Funeral Rule

There are some legal protections available to consumers of funeral home services. The Funeral Rule, enforced by the Federal Trade Commission (FTC), requires funeral providers to give consumers accurate, itemized price information and other disclosures about funeral goods and services. The Rule also prohibits funeral providers from misrepresenting service-related requirements and from engaging in unfair or deceptive practices.

The key feature of the Funeral Rule is the General Price List, which entitles consumers to receive itemized prices for the various goods and services offered, allowing them to comparison shop and to purchase goods and services on an itemized basis, and not solely as part of a package. For more information on shopping for funeral services, the Funeral Rule, and prepaying for some or all of the expenses involved, visit the FTC consumer website www.consumer.ftc.gov.

State law protections

The Funeral Rule generally governs funeral providers. It does not offer specific remedies or causes of action for consumers who are victims of funeral providers that do not comply with the Rule. Laws in individual states regulate funeral providers and help ensure that advance payments are available when they're needed. However, protections vary widely from state to state, sometimes providing a window of opportunity for unscrupulous operators.

What can you do?

Before entering into a prepaid agreement, here are some steps you can take to safeguard your funds and ensure you'll get the services you've payed for:

- Find out what kind of consumer protection your state provides and whether it regulates the payment methods.
- Be sure that your funds or insurance policy are held in a trust at a reputable bank or other financial institution that you can check on to be sure your money or policy is safe. You may even be entitled to an annual statement.
- If you're funding some or all of the pre-need arrangements with life insurance purchased through the funeral services provider, be sure the policy is permanent insurance, such as whole life, and not term insurance (if you outlive the term of the policy, there will be no insurance proceeds to pay for your funeral).
- The agreement should address what happens to any excess funds that may be available after paying for your services. Some pre-need contracts allow you to designate how excess funds are to be disposed (e.g., surviving family members, your church or other charity).
- Along those same lines, if you cancel the contract, you may be entitled to a partial or full refund, although some states allow the funeral provider to retain a portion of the funds, often depending on how long the contract has been in existence.

Ultimately, be sure to tell your family about the plans you've made and where you'll keep important documents, such as your last will and testament and any documentation you've retained concerning your pre-need funeral arrangements.

Avoiding Probate: Is It Worth It?

Why avoid probate?

- ***It can be slow; getting needed assets into the hands of your heirs may be delayed***
- ***It can be costly, especially if an estate is large or complex, or ancillary probate is needed***
- ***It is public; documents that you wish to remain private can be accessed by the public***

How to avoid probate

- ***Own assets jointly with right of survivorship***
- ***Own assets that pass by beneficiary designation, such as life insurance and retirement plans***
- ***Use a trust***
- ***Gift assets during your lifetime***

When you die, your estate goes through a process that manages, settles, and distributes your property according to the terms of your will. This process is governed by state law and is called probate. Probate proceedings fall under the jurisdiction of the probate court (also called the Surrogate's, Orphans', or Chancery court) of the state in which you are domiciled at the time of your death. This court oversees probate of your personal property and any real estate that is located in that state. If you own property located in a state other than the state in which you are domiciled at the time of your death, a separate "ancillary" probate proceeding may need to be initiated in the other state.

Note: *"Domicile" is a legal term meaning the state where you intend to make your permanent home. It does not refer to a summer home or a temporary residence.*

Items that are subject to probate are known as probate assets. Probate assets generally consist of any property you own individually at the time of your death that passes to your beneficiaries according to the terms of your will. Examples of nonprobate assets include property that is owned jointly with right of survivorship (e.g., a jointly held bank account) and property that is owned as tenants-by-the-entirety (i.e., real property owned jointly by a husband and wife). Other examples are property that passes to designated beneficiaries by operation of law, such as proceeds of life insurance and retirement benefits, and property held in trust. Property that does not pass by will, right of survivorship, beneficiary designation, or trust will also be subject to probate.

Why avoid probate?

Most wills have to be probated. The rules vary from state to state, but in some states, smaller estates are exempt from probate, or they may qualify for an expedited process.

Probate can be slow. Depending on where your executor probates your estate and the size of your probate estate, the probate process can take as little as three months or as long as three years. Three years can be a long time to wait for needed income. It can take even longer if the estate is a complicated one or if any of the heirs are contesting the will.

Probate can be costly. Probate costs usually include court costs (filing fees, etc.), publication costs for legal notices, attorney's fees, executor's fees, bond premiums, and appraisal fees. Court costs and attorney's fees can vary from state to state. Typically, the larger the estate, the greater the probate costs. However, if a smaller estate has complex issues associated with its administration or with distribution of its assets (e.g., if the person who died owned property in several states), probate can be quite costly.

Probate is a public process. Wills and any other documents submitted for probate become part of the public record--something to consider if you or your family members have privacy concerns.

Why choose to go through probate?

For most estates, there's usually little reason to avoid probate. The actual time and costs involved are often modest, and it just doesn't make sense to plan around it. And there are actually a couple of benefits from probate. Because the court supervises the process, you have some assurance that your wishes will be abided by, and if a family squabble should arise, the court can help settle the matter. Further, probate offers some protection against creditors. As part of the probate process, creditors are notified to make their claims against the estate in a timely manner. If they do not, it becomes much more difficult for them to make their claims later on.

In addition, some states require that your will be probated before the beneficiaries under your will can exercise certain rights. Among the rights that may be limited are the right of your surviving spouse to waive his or her share under the will and elect a statutory share instead, use your residence during his or her remaining life, set aside certain property, and receive a family allowance.

How to avoid probate

An estate plan can be designed to limit the assets that pass through probate or to avoid probate altogether. Property may be passed outside of probate by owning property jointly with right of survivorship; by ensuring that beneficiary designation forms are completed for those types of assets that allow them, such as IRAs, retirement plans, and life insurance (to avoid probate you shouldn't name your estate as beneficiary); by putting property in a trust; and by making lifetime gifts.

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What is the Roth 401(k) five-year rule?

The Roth 401(k) five-year rule determines when you can begin receiving tax-free qualified distributions from your 401(k) plan Roth account. While it's similar to the five-year rule that applies to Roth IRAs, there are important differences.

Withdrawals from your Roth 401(k) plan account--including both your contributions and any investment earnings--are completely tax and penalty free if you satisfy a five-year holding period *and* one of the following also applies:

- You've reached age 59½
- You have a qualifying disability, or
- The withdrawal is made by your beneficiary or estate after your death

The five-year holding period begins on the first day of the calendar year in which you make your first Roth 401(k) contribution (regular or rollover) to the plan. For example, if you make your first Roth contribution to your company's 401(k) plan in December 2015, your five-year holding period begins on January 1, 2015, and ends on December 31, 2019.

If you participate in 401(k) plans maintained by different employers, your five-year holding period is determined separately for each plan. But there's an important exception. If you make a direct rollover of Roth dollars from your prior employer's plan to your new employer's plan, your five-year holding period for the new plan will be deemed to start with the year you made your first Roth contribution to the prior plan.

For example, Beth made Roth contributions to the Acme 401(k) plan beginning in 2011. In 2015, she changed jobs and began making Roth contributions to the Beacon 401(k) plan. Her five-year holding period for the Acme plan began on January 1, 2011, and ends on December 31, 2015. Her five-year holding period for the Beacon plan began on January 1, 2015, and ends on December 31, 2019. In 2015, Beth decides to make a direct rollover of her Acme Roth account to Beacon's 401(k) plan. Because of the rollover, Beth's January 1, 2011, starting date at Acme will carry over to the Beacon plan, and any distributions she receives from her Beacon Roth account after 2015 (rather than 2018) will be tax free (assuming she's at least age 59½ or disabled at the time of distribution).

What is the Roth IRA five-year rule?

Actually, there are *two* five-year rules you need to know about. The first five-year rule determines when you can begin receiving tax-free qualified distributions from your Roth IRA. Withdrawals from your Roth IRA--including both your contributions and any investment earnings--are completely tax and penalty free if you satisfy a five-year holding period *and* one of the following also applies:

- You've reached age 59½ by the time of the withdrawal
- The withdrawal is made due to a qualifying disability
- The withdrawal is made for first-time homebuyer expenses ($10,000 lifetime limit)
- The withdrawal is made by your beneficiary or estate after your death

This five-year holding period begins on January 1 of the tax year for which you made your first contribution (regular or rollover) to any Roth IRA you own. For example, if you make your first Roth IRA contribution in March 2015 and designate it as a 2014 contribution, your five-year holding period begins on January 1, 2014 (and ends on December 31, 2018). You have only one five-year holding period for determining whether distributions from any Roth IRA you own are tax-free qualified distributions. (Roth IRAs you *inherit* are subject to different rules.)

The second five-year rule is a little more complicated. When you convert a traditional IRA to a Roth IRA, the amount you convert (except for any after-tax contributions you've made) is subject to income tax at the time of conversion. However, your conversion isn't subject to the 10% early distribution penalty, even if you haven't yet reached age 59½.

But what the IRS giveth it can also taketh away. If you withdraw any portion of your taxable conversion within five years, you'll have to pay the 10% early distribution penalty on those funds that you previously avoided--unless you've reached age 59½ or qualify for another exemption from the penalty tax. This five-year holding period starts on January 1 of the year you convert your traditional IRA to a Roth IRA. And if you have more than one conversion, each will have its own separate five-year holding period for this purpose.

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Peace In Our Time

What was the most peaceful era of human history? The 200-year-long *Pax Romana* in the Roman Empire? The peaceful period in Asia following the Mongol conquests? The Ming dynasty in China?

You probably haven't considered our present times, since we're constantly reading about the spread of ISIS, incursions by the Taliban in Afghanistan, and what appears to be an escalating conquest of Ukraine by neighboring Russia. Every day you read about the threat of terrorist attacks.

But evolutionary psychologist Steven Pinker, author of "The Better Angels of Our Nature," has compiled statistics which make a compelling case that fewer people are dying as a result of violence in today's world than at any time in history. The wars we hear about are relatively contained—when you add up the populations of Syria, Iraq, Afghanistan and eastern Ukraine (and not every citizen in those nations is directly impacted by war), it comes to just 1.37% of the world population. And the peaceful zones in between are much greater in this century now that we've given up the habit of waging world wars.

Pinker offers some interesting perspectives; for instance, deaths in warfare among certain aboriginal tribes in New Guinea and Fiji were higher than in Germany throughout two world wars. But his definition of peace is broader than simply fewer armed conflicts; he also takes into account murder rates and civilian violence in countries around the world. The murder rate during the gold rush in California was among the highest in recorded history; today, California is hardly a bastion of violence. In Europe, torture and public executions were common, and it was not uncommon to see severed heads resting on spikes as you entered a city. Today this kind of thing is rare globally and virtually nonexistent in the Western states. Slavery has been abolished, and the laws have had a significant dampening effect on the once-common instances of rape, infanticide, lynch mobs and cruelty to animals.

The conclusion of the book is that not only are we living in the most peaceful time in world history, but that this may be the least-appreciated development in the history of our species.

Which countries are the most and least peaceful? For that information, you turn to the Global Peace Index, which was created by the Economist magazine from data compiled by the Institute for Economics and Peace. The methodology is detailed; each country is ranked based on its relations with neighboring countries (being at war earns a low score; the U.S./Canadian border earns the highest); level of internal conflict (countries embroiled in civil wars receive low scores); political instability; terrorist activity; number of homicides per 100,000 people; level of violent crime; number of jailed persons per 100,000 citizens; military expenditure as a percentage of GDP; and citizen access to small arms and light weapons.

In general, the Institute found that peace tends to be found in countries with higher income, schooling, high levels of government transparency and low corruptions. You also find greater measures of peace in stable countries that are part of regional blocks (think: Eurozone).

The most recent ranking, completed in 2014, lists Iceland, New Zealand, Switzerland, Finland, Austria, Norway, Belgium, Japan, Canada and Denmark as the top ten most peaceful countries, and their overall rankings are pretty similar. To find the United States, you have to go all the way down to number 101, where the high homicide rate, highest per-capita number of people in jails, huge military expenditures and high number of external conflicts that the military is engaged in all pull the ranking down. Not surprisingly, the bottom of the scale includes Iraq, Afghanistan, the Democratic Republic of the Congo, Syria, Sudan and Somalia—the most well-publicized war zones.

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The Doctor On Your Wrist

You may think that medical costs are going to bankrupt America, and if we assume that Medicare and Medicaid costs will rise as they have for the past 20 years (despite the brief interlude these last three years), then there is reason for alarm. But ask yourself: how much of those costs are related to expensive diagnostic tests? How much are related to fixing major health problems after the fact, when they could have been prevented if we had only known where to look and at what lifestyle changes to make?

What the bean counters are missing when they simply project ever-larger expenditures based on past experience is the enormous impact that wearable diagnostics are going to have on healthcare in general. You already know about Fitbit, which helps you get in shape by tracking the number of steps you take each day and week, and now also tracks heart rate, calories burned and stairs climbed. More recent innovations are the Sensoria smart sock, which diagnoses your running stride and can reliably identify a runner's rookie mistake of heel striking. If you've gone to a hospital to evaluate your endurance, well, you could have used the PerformTech heart-rate monitor, which calculates your endurance simply from five minutes on a stair-stepper.

Not getting enough sleep? Or the right kind of sleep? The Withing's Aura bed pad will diagnose the quality of your REM cycle. An app by Sleeprate will tell you when you have restless cycles. If you're one of those people who has trouble getting into meditation, you might try the Muse headband, which contains an EEG device that measures brainwaves, and helps coach you into a state of meditative peace. It also tracks your meditative progress over time.

Wouldn't it be nice if all of these devices were included in the same device? As you read this, ten different companies from around the world are competing for an X Prize that will be given to the first "tricorder," the device from Star Trek that was used to diagnose the damage to crew members after a rough battle with the Klingons. The winner of the Tricorder X Prize will be able to monitor your body temperature, oxygen levels and heart rate, tell if you're anemic, check your blood pressure and perform a constant EEG. It will diagnose common maladies like stroke and less common ones, like tuberculosis.

Meanwhile, if you saw the episodes of Jeopardy where a computer named Watson cleaned up the board, well, you saw the next major diagnostic engine. At this moment, Watson is busy absorbing all the medical literature, and is helping real doctors make proper diagnoses and offer remedies. IBM, the maker of Watson, expects to put the program in the Cloud, where it will be accessible to, among other things, mobile devices.

The combination of the next generation of wearable diagnostics uploading data to Watson for instant analysis will allow all of us to have our health monitored constantly in real time—by affordable devices that are as sensitive as the expensive hospital equipment that currently hits the global healthcare budget so hard. When you begin to have a problem, the wearable device will schedule a medical exam. If you start to experience the early stages of a heart attack or stroke, the ambulance will arrive at your door—before you realize you have a problem. The treatments will be much less expensive, because the problems will be caught in the very early stages.

How many billions of dollars will this save? The bean counters who draw the alarming graphs haven't even started to realize that they're living in the middle of a health care revolution. But now *you* do.

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Blog Updates for June: Articles of Interest

Education Planning Articles

Discover Every Student Loan Forgiveness Option By State
How To Get Your Student Loans Out Of Default With Rehabilitation
Tax Strategy For College Wipes Out $26,000 A Year In Capital Gains

Estate Planning Articles

How To Manage Digital Assets After Death Of The Account Holder
Irrevocable Trusts, Not So Irrevocable After All
The Able Act Provides New Alternatives to Help With Disability Planning
End of Life Planning
Asset Protection Planning for Physicians

Financial Advisor Articles

None this month

Financial Planning Articles

The Do's And Don'ts Of Charitable Pledge Donations

Insurance Planning Articles

None this month

Investment Planning Articles

Three And A Half Years Since The Last 10% Correction
The Pros and Cons of a Strong Dollar

Retirement Plan Articles

None this month

Retirement Planning Articles

Social Security Survivor Benefit Coordination

Tax Planning Articles

None this month