

Legal Alert:

Valuing IRA Annuities in Roth IRA Conversions

August 22, 2005

On August 19, 2005, the Treasury issued proposed and temporary regulations governing the valuation of annuity contracts in conversions from traditional IRA's to Roth IRA's. Pursuant to Code sections 408(d)(1) and (2), and as provided in Treas. Reg. §1.408A-4, Q&A-7 as adopted in 1999, the amount converted from the traditional IRA is treated as distributed and taxable in the year of conversion.

The new temporary regulations, which are effective for any Roth IRA conversion where an annuity contract is deemed distributed on or after August 19, provide that the amount treated as distributed is the fair market value of the annuity contract on the date of conversion, and follow an approach similar to the gift tax regulations in making that valuation:

- If the conversion occurs soon after purchase of the annuity contract, fair market value is established by the premiums paid;
- If the conversion occurs after the contract has been in force for some time and no further premiums are to be paid, fair market value is determined through the sale by the insurance company of comparable contracts; and
- If the conversion occurs after the contract has been in force for some time and further premiums are to be paid, fair market value is determined through an approximation based on the interpolated terminal reserve on the conversion date, plus the proportionate amount of the last gross premium payment reflecting the period of paid-up coverage extending beyond the conversions date; provided, however, that this approximation may not be used if it is not reasonably close to full value because of the "unusual nature" of the contract.

These rules were promulgated in response to the use of springing cash value annuity contracts to reduce the taxable income recognized in a Roth IRA conversion.

The temporary regulations also authorize the Service to issue additional guidance regarding the fair market value of a traditional IRA annuity. The preamble notes that such guidance is expected to be similar to Rev. Proc. 2005-25, the safe harbor formulas for valuing

life insurance and other products providing death benefit protection when distributed from qualified plans, except that the surrender charge adjustment will not exceed 9% and the value of all additional benefits (such as guaranteed minimum death benefits) must be taken into account.



For more information regarding this alert, please contact any of the following attorneys:

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