Part III

Administrative, Procedural and Miscellaneous

26 CFR 601.201: Rulings and determination letters.
(Also Part I, §§ 408 and 408A; §1.408A-4T.)

Rev. Proc. 2006-13

SECTION 1. PURPOSE

This revenue procedure provides safe harbor methods that are permitted to be used in determining the fair market value of an annuity contract for purposes of determining the amount includible in gross income as a result of the conversion of a traditional IRA to a Roth IRA, as described in Q&A-14 of §1.408A-4T of the temporary regulations. The safe harbor method provided in Section 3 of this revenue procedure is available to determine the fair market value of an annuity contract that has not yet been annuitized with respect to any Roth IRA conversion described in A-14 of §1.408A-4T until further guidance is issued. The simplified safe harbor method provided in Section 4 of this revenue procedure is available where such a conversion occurs before January 1, 2006.

SECTION 2. BACKGROUND

Under §408(d) of the Code and A-7 of § 1.408A-4 of the regulations, any amount that is converted from a traditional IRA to a Roth IRA is includible in gross income as a distribution for the taxable year in which the amount is distributed or transferred from the traditional IRA. In the case of a conversion involving property, the conversion amount generally is the fair market value of the property on the date of distribution or the date the property is treated as distributed from the traditional IRA. Under A-1 of §1.408A-7, any amount converted from a traditional IRA to a Roth IRA is treated as a distribution for which a Form 1099-R must be filed by the trustee maintaining the traditional IRA.

Temporary regulations under § 408A regarding the valuation of annuity contracts upon conversion of a traditional IRA were published in the Federal Register on August 22, 2005 (T.D. 9220, 2005-39 I.R.B. 596 [70 FR 48868]). Section 1.408A-4T, A-14 of the temporary regulations states that, when a traditional individual retirement annuity is converted to a Roth IRA, the amount that is treated as distributed is the fair market value of the annuity contract on the date the annuity contract is converted. Similarly, when a traditional individual retirement account holds an annuity contract as an account asset and the account is converted to a Roth IRA, the amount that is treated as distributed with respect to the annuity contract is the fair market value of the annuity contract on the date the annuity contract is distributed or treated as distributed from the traditional IRA.

A-14 of §1.408A-4T does not apply to a conversion of a traditional IRA where the conversion is accomplished by the complete surrender of an annuity contract for its cash value and the reinvestment of the cash proceeds in a Roth IRA, but only if the surrender extinguishes all benefits and other characteristics of the contract. A-14 of §1.408A-4T does not apply in that circumstance because the contract is not being converted. Instead, the cash from the surrendered contract is reinvested in the Roth IRA.

A-14 of §1.408A-4T also provides rules for determining the fair market value of an annuity contract in the case of a conversion. These rules vary depending on certain factors, including whether the conversion occurs soon after the contract was sold, whether there has been a material change in market conditions, and whether future premiums are to be paid. A-14 of §1.408A-4T applies to any conversion where an annuity contract is distributed or treated as distributed from a traditional IRA on or after August 19, 2005. As indicated in the preamble to the temporary regulations, no implication is intended concerning whether or not a rule adopted in the regulations is applicable law for earlier conversions.

The temporary regulations also provide authority for the Commissioner to issue additional guidance regarding the fair market value of an annuity contract, including formulas to be used in determining fair market value. The Service and Treasury requested and received comments regarding this anticipated guidance. Commentators indicated that a more specific methodology for valuing the annuity contracts is needed and noted that they are currently implementing the method under A-12 of §1.401(a)(9)-6 of the regulations for valuing annuity contracts that have not yet been annuitized.

Under A-12 of §1.401(a)(9)-6, an employee's entire interest under an annuity contract that has not yet been annuitized (which is used to determine the employee's required minimum distribution) is the sum of the following: (1) the dollar amount credited to the employee or beneficiary under the contract (which may not be reduced to reflect any surrender charges under the contract) and (2) the actuarial present value of any additional benefits (such as survivor benefits in excess of the account balance, any guaranteed minimum benefits, and any charges that are expected to be refunded, rebated or otherwise reversed at a later date) that will be provided under the contract.

For this purpose, the actuarial present value of any additional benefits is to be determined using reasonable actuarial assumptions, including reasonable assumptions as to future distributions, and without regard to an individual's health. However, paragraph (c)(1) of A-12 of §1.401(a)(9)-6 provides that the actuarial present value of the additional benefits may be disregarded if: (1) the sum of the dollar amount credited to the employee or beneficiary under the contract and the actuarial present value of the additional benefits is no more than 120 percent of the dollar amount credited to the employee or beneficiary under the contract and (2) the additional benefits satisfy certain other requirements. Also, paragraph (c)(2) of A-12 of §1.401(a)(9)-6 provides that the actuarial value of the right to receive a final payment upon death that does not exceed the excess of the premiums paid less the amount of prior distributions may also be disregarded if it is the only additional benefit under the contract. Because some benefits may be disregarded, the methodology of A-12 of §1.401(a)(9)-6 does not always reflect the full value of all of the benefits under the contract.

SECTION 3. SAFE HARBOR METHOD FOR ROTH IRA CONVERSIONS

The Service and Treasury recognize that it may be difficult to determine the fair market value of an annuity contract under the temporary regulations. Moreover, the Service and Treasury believe it is appropriate to permit the use of a modified version of the methodology applied under A-12 of §1.401(a)(9)-6 as a safe harbor method to be used in determining the fair market value of such an annuity contract. Accordingly, this revenue procedure provides that, until further guidance is issued, for purposes of determining the amount includible in gross income as a result of the conversion of a traditional IRA to a Roth IRA as described in A-14 of §1.408A-4T, the fair market value of an annuity contract that has not yet been annuitized is permitted to be determined using the methodology provided in A-12 of §1.401(a)(9)-6 with the following modifications:

1. All front-end loads and other non-recurring charges assessed in the twelve months immediately preceding the conversion must be added to the account value.
2. Future distributions are not to be assumed in the determination of the actuarial present value of additional benefits.
3. The exclusions provided under paragraphs (c)(1) and (c)(2) of A-12 of §1.401(a)(9)-6 are not to be taken into account.

SECTION 4. SIMPLIFIED SAFE HARBOR METHOD FOR PRE-2006 ROTH IRA CONVERSIONS

The Service and Treasury recognize that Forms 1099-R must soon be issued for Roth IRA conversions occurring in 2005. Accordingly, this section 4 provides that, in the case of a Roth IRA conversion where an annuity contract that has not yet been annuitized is distributed or treated as distributed before January 1, 2006, for purposes of determining the amount includible in gross income as a result of the conversion of a traditional IRA to a Roth IRA as described in A-14 of §1.408A-4T, the fair market value of the contract is permitted to be determined using the methodology provided in A-12 of §1.401(a)(9)-6 except that all front-end loads and other non-recurring charges assessed in the twelve months immediately preceding the conversion must be added to the account value.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Larry Isaacs and Robert Walsh of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue procedure, contact the Employee Plans taxpayer assistance telephone service between the hours of 8:00 a.m. and 6:30 p.m. Eastern time, Monday through Friday, by calling (877) 829-5500 (a toll-free number). Mr. Isaacs and Mr. Walsh may be reached at (202) 283-9888 (not a toll-free number).