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## RMD “Entire Interest” Rule Goes Into Effect for 2006



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### SITUATION

Beginning in 2006, the rules for calculating required minimum distributions from IRA annuities and 403(b) annuity contracts must take into account not only the account value but also the value of any additional benefits provided under the contract. These additional benefits include any enhanced living benefits and/or death benefits that may be provided under the contract.

### PROBLEM

The required minimum distribution (“RMD”) rules for qualified plans and IRAs were dramatically simplified in 2002. Probably the most important change under the 2002 final regulations was the creation of the Uniform Lifetime Table that provides a uniform divisor for single or married account owners in determining their RMDs.

In addition, temporary regulations were adopted in 2002 that added a new rule that required that the RMD calculation be based not only on the IRA annuity’s account value but also on the actuarial present value of any other benefits (such as minimum survivor benefits) provided under the annuity contract. The effective date of this “entire interest” rule under the 2002 temporary regulations was postponed and goes into effect for the first time for RMD calculations for 2006

### SOLUTION

Under the new “entire interest” rule, in determining RMDs for 2006 and future years, the divisor under the Uniform Lifetime Table must be applied to the annuity contract’s account value (“Account Value”) plus the actuarial present value of any additional benefits (“Additional Benefits”) provided under the contract.

$$\text{RMD} = \frac{\text{Account Value} + \text{Additional Benefits}}{\text{Divisor}}$$

Previously, the divisor was applied only to the account value of the IRA annuity contract. In a sense, the IRS is recognizing that today’s annuity contracts may include features, in the form of optional premium-paying riders, which enhance the value of those contracts in a way that needs to be taken into account in the RMD calculation.

Depending on the contract, these can include death benefit riders that can provide capital preservation benefits and lifetime benefit riders that can guarantee minimum income, accumulation or withdrawal benefits.

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## **SIGNIFICANCE**

### **Two Important Exceptions**

There are two important exceptions that allow the actuarial value of any additional benefits to be disregarded.

#### **Exception #1: When the Only Additional Benefit is a Return of Premium Death Benefit**

No additional RMDs are required if the only additional benefit provided under the contract is a return of premium death benefit regardless of the actuarial value of that death benefit.

#### **Exception #2: When Total Additional Benefits Are Worth 20% or Less of Account Value and Are Reduced Pro Rata by Distributions**

No additional RMDs are required if the total actuarial present value of all additional benefits does not exceed 20% of the account value and the contract provides only for the following additional benefits:

- (i) Additional benefits that are reduced pro rata by the amount of any distribution; and
- (ii) An additional benefit that meets the Return of Premium Death Benefit exception.

#### **Common and Practical Implications for IRA Annuity Owners:**

- Many companies will calculate the actuarial present value of all additional benefits, determine whether either of the exceptions applies, and provide the IRA annuity owner with a statement containing the proper RMD for the year. That statement should be distributed to IRA annuity owners by January 31 each year with a copy also sent to the IRA annuity owner's advisor of record.
- In cases where no exception applies, the RMD will increase only to take into account the value of any additional benefits that the IRA owner is receiving under the contract. The IRA annuity owner can use that additional distribution for any purpose. Incidentally, where the IRA annuity owner has more than one IRA, the additional amount can be taken either from the IRA annuity or, if preferred, from any other IRA owned by the IRA annuity owner.
- While each case must be looked at individually, it appears that in most cases the "entire interest" rule will have a modest, if any, impact on required distributions. In addition, in the case of IRA owners who, based on their retirement income needs or other planning considerations, take annual distributions in excess of the minimum distribution required under the RMD rules, the entire interest rule is not likely to have a significant impact.