Internal Revenue Service

Significant Index No. 72.20-04

Department of the Treasury

Washington, DC 20224 200214029

Person to Contact:

Telephone Number:

Refer Reply to:

T:EP:RA:T:A2

Date:

OCT 25 2001

In re: Request for ruling on behalf of

Dear

This letter is in response to your request on behalf of Taxpayer M, dated January 9, 2001, in which you asked for a ruling as to whether certain proposed distributions from an individual retirement account (IRA 2) owned by Taxpayer M are part of a series of substantially equal periodic payments and are, therefore, not subject to the 10 percent additional tax imposed on premature distributions under section 72(t) of the Internal Revenue Code (Code). The ruling request was amended by you in a telephone call with of our office on October 1, 2001, and by a letter faxed to our office on October 2, 2001, to clarify the methodology used to calculate distributions and provide additional information regarding Taxpayer M.

According to the facts as stated, Taxpayer M is the owner of an individual retirement account (IRA 1) from which distributions were taken in 1999 and 2000. Taxpayer M attained age 56 in 2001. Because the distributions from IRA 1 in 1999 and 2000 were taken prior to Taxpayer M attaining age 59 ½, Taxpayer M paid the additional 10 percent tax required under section 72(t) of the Code on these distributions. Taxpayer M has a disability that results in additional medical and living expenses over and above what might normally be expected for an individual of the same age. Taxpayer M expects medical expenses to increase due to planned upcoming medical procedures related to Taxpayer M's disability. Taxpayer M uses IRA distributions to meet current and projected living expenses, and needs to take distributions that are sufficient to pay anticipated expenses and that are not subject to the additional tax imposed under section 72(t) of the Code. Upon receiving a favorable response to this ruling request, Taxpayer M would like to transfer more than one-half of the assets of IRA 1 to another IRA, IRA 2, and commence distributions from IRA 2 in 2001 in a form that would satisfy the section 72(t)(2)(A)(iv) exception for substantially equal periodic payments. An annual distribution amount to be distributed from IRA 2 will be calculated by dividing the balance of IRA 2, as of the date of transfer, by an annuity factor obtained from Table S in IRS Publication 1457 (7-1999), Actuarial Values, Book Aleph, using Taxpayer M's age in 2001 and an interest rate of 8.4 percent. The annual distribution amount divided by 12 will be the monthly distribution amount.

131

Once the monthly distribution amount is calculated, the same amount will be distributed each month thereafter. All distributions will be taken from IRA 2 and only from IRA 2.

Ruling Requested

Based on these facts, you have requested the following ruling.

The proposed method of determining periodic payments satisfies one of the methods described in Notice 89-25 and results in substantially equal periodic payments within the meaning of section 72(t)(2)(A)(iv) of the Code, and such payments will not be subject to the additional tax of section 72(t)(1) unless the requirements of section 72(t)(4) are not met.

Applicable Law

Section 408(d) of the Internal Revenue Code provides that amounts paid or distributed out of an individual retirement plan must be included in gross income by the payee or distributee in the manner provided under section 72 of the Code.

Section 72 of the Internal Revenue Code provides rules for determining how amounts received as annuities, endowments, or life insurance contracts and distributions from qualified plans are to be taxed.

Section 72(t) of the Internal Revenue Code was added to the Code by the Tax Reform Act of 1986 (TRA '86), effective generally for taxable years beginning after December 31, 1986. Section 72(t)(1) provides for the imposition of an additional 10 percent tax on early distributions from qualified plans, including IRAs. The additional tax is imposed on that portion of the distribution that is includible in gross income.

Section 72(t)(2)(A)(iv) of the Code provides that section 72(t)(1) shall not apply to distributions which are part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of such employee and his beneficiary.

Section 72(t)(4) of the Code imposes the additional limitation on distributions excepted from the 10 percent tax by section 72(t)(2)(A)(iv) that, if the series of payments is subsequently modified (other than by reason of death or disability) before the later of (1) the close of the 5-year period beginning with the date of the first payment and (2) the employee's attainment of age 59 1/2, then the taxpayer's tax for the first taxable year in which such modification occurs shall be increased by an amount determined under regulations, equal to the tax that would have been imposed except for the section 72(t)(2)(A)(iv) exception, plus interest for the deferral period.

132

Notice 89-25, 1989-1 C.B. 662, provides guidance, in the form of questions and answers, on certain provisions of the Tax Reform Act of 1986 (TRA '86). In the absence of regulations on section 72(t) of the Code, this notice provides guidance with respect to the exception to the tax on premature distributions provided under section 72(t)(2)(A)(iv). Q&A-12 of Notice 89-25 provides three methods for determining substantially equal periodic payments for purposes of section 72(t)(2)(A)(iv) of the Code. Two of these methods involve the use of an interest rate assumption that must be an interest rate that does not exceed a reasonable interest rate on the date payments commence.

Proposed Methodology

The proposed method for determining annual periodic payments described in the ruling request, as modified, is to calculate an annual distribution amount for 2001 by dividing the account balance of IRA 2 as of the date assets are transferred from IRA 1 to IRA 2 by an annuity factor (obtained from Table S in IRS Publication 1457 (7-1999), Actuarial Values, Book Aleph, using the age attained by Taxpayer M in 2001 and an interest rate of 8.4 percent). The annual distribution amount divided by 12 will equal the monthly distribution amount. Once calculated, the same monthly distribution amount will be distributed each month thereafter. All distributions will be taken from IRA 2, and only from IRA 2.

Conclusion

The mortality table and interest rate used in the calculation of the annuity factor are such that they do not result in the circumvention of the requirements of sections 72(t)(2)(A)(iv) and 72(t)(4) of the Code (through the use of an unreasonable mortality table or an unreasonably high interest rate).

Accordingly, we conclude that the proposed method (as modified) of determining periodic payments satisfies one of the methods described in Notice 89-25 and results in substantially equal periodic payments within the meaning of section 72(t)(2)(A)(iv) of the Code, and such payments will not be subject to the additional tax of section 72(t) unless the requirements of section 72(t)(4) are not met.

This ruling is directed only to the individual that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

Sincerely yours,

Martin L. Pippins

Martin L. Pippins, Manager
Employee Plans Actuarial Group 2
Tax Exempt and Government Entities Division

134