Internal Revenue Service

Department of the Treasury

Washington, DC 20224

200051052

Significant Index No. 72.20-04

Contact Person:

Telephone Number:

In Reference to:

Date T:EP:RA:T:A2

SEP 29 2000

In re: Request for ruling on behalf of

Taxpayer T =

This letter is in response to your request, dated January 31, 2000, in which you asked for a ruling as to whether certain proposed distributions from an individual retirement account (IRA) owned by Taxpayer T are part of a series of substantially equal periodic payments and are therefore not subject to the 10 percent additional tax imposed under section 72(t) of the Internal Revenue Code (Code). The ruling request was amended by you as the taxpayer's authorized representative (pursuant to Form 2848) in a letter dated May 17, 2000, and in telephone calls with of our office, including calls on August 23, 2000, and on August 30, 2000, to modify the age and interest rate used in the methodology used to calculate distributions for 2000 and subsequent years.

According to the facts as stated, Taxpayer T is the owner of two IRAs (IRA 1 and IRA 2) which were merged by a trustee to trustee transfer into a third IRA (IRA 3) on May 31, 1999. Taxpayer T attained age 58 in 1999. Taxpayer T started taking distributions from IRA 3 in 1999, and calculated an annual distribution amount for 1999 by dividing the aggregated account balances of IRAs 1 and 2 as of December 31, 1998, by an age 58 annuity factor from Table S (IRS Publication 1457 Actuarial Values: Aleph Volume), using an assumed interest rate of 8 percent. Taxpayer T wants to avoid the additional 10 percent tax, imposed under section 72(t)(1) on early distributions, by using the exception provided in section 72(t)(2)(A)(iv) of the Code for substantially equal periodic payments. Taxpayer T will attain age 59 in 2000. Taxpayer T proposes to calculate the annual distribution amount for 2000 by dividing the December 31, 1999, account balance of IRA 3 by an annuity factor derived from Table S (as published in July 1999), using Taxpayer T's age attained in 2000 and an interest rate equal to 120 percent of the federal mid-term rate in effect for January 2000 (rounded down to the nearest "even" tenth of a percent). The annual distribution amount for succeeding years will be calculated in the same manner; that is, the account balance of IRA 3 as of December 31 of the prior year will be divided by an annuity

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factor from Table S, with such annuity factor derived using Taxpayer T's age attained in the distribution year and an interest rate equal to 120 percent of the federal mid-term rate for January of the distribution year (rounded down to the nearest even tenth of a percent). All distributions will be taken from IRA 3.

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 which would have been imposed except for the section 72(t)(2)(A)(iv) exception, plus interest for the deferral period.

Section 1.72-9 of the Income Tax Regulations (Regulations) provides tables that are to be used in connection with computations under section 72 and the regulations thereunder. Included in this section are tables giving life expectancies for one life (Table V) and joint life and last survivor expectancies for two lives (Table VI).

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 which 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 end-of-year annual distribution amount by dividing the account balance of IRA 3 as of the end of the prior year by an annuity factor, with such annuity factor derived from Table S of IRS Publication 1457 using the age attained in the distribution year and a specified interest rate. The annual end-of-year distribution amount for 1999 was derived by dividing the aggregated account balances as of December 31, 1998, of the two IRAs (IRA 1 and IRA 2), which were merged into IRA 3, by an annuity factor derived from Table S (as included in IRS Publication 1457 (8-89) Actuarial Values, Alpha Volume), using an effective annual interest rate of 8 percent and Taxpayer T's age attained in 1999. For the year 2000 and subsequent years, an end-of-year annual distribution amount will be calculated by dividing the account balance of IRA 3, as of December 31 of the prior year, by an annuity factor, with such annuity factor derived from the currently effective Table S (currently included in IRS Publication 1457 (7-1999), Actuarial Values, Book Aleph) using Taxpayer T's age attained in the distribution year and an effective annual interest rate equal to 120 percent of the federal mid-term rate (used for purposes of Code section 1274(d), and rounded down to the nearest even tenth of a percent) in effect for

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January of the year for which the distribution is calculated. For example, where 120 percent of the federal mid-term rate is a rate that is greater than 7.2 and less than 7.4 (such as 7.23, 7.35, or 7.39), the rate will be rounded down to 7.2. All annual distribution amounts will be taken out of IRA 3, and only from IRA 3.

Conclusion

The annuity factor and the interest rate used 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 annuity factor 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
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