Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Significant Index No. 72.20-04

Contact Person:

Telephone Number:

In Reference to:

Date: T:EP:RA:T:A2

NOV 09 2000

In re: Request for ruling on behalf of

This letter is in response to your request, dated July 24, 2000, in which you asked for a ruling as to whether certain proposed distributions from certain individual retirement accounts (IRAs) owned by you 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 in a telephone call with . of our office on October 23, 2000, and confirmed in a follow-up letter dated October 26, 2000, to modify the methodology used to calculate distributions for 2001 and subsequent years.

According to the facts as stated, you are the owner of two traditional IRAs (IRA 1 and IRA 2), and you are a participant in two plans sponsored by your employer, a plan described in section 401(k) of the Code and a defined benefit plan with a cash balance feature. You will attain age 50 in 2001, and are planning to retire in that same year. Upon retirement in 2001, you plan to roll over your account balance under the section 401(k) plan and the single-sum distribution you will receive from the cash balance plan into one of your two traditional IRAs, and you wish to start taking monthly distributions from these two IRAs in July 2001. You want 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. You will calculate a monthly distribution amount for each year by first calculating an annual distribution amount, and then dividing the annual distribution amount by 12 to obtain a monthly distribution amount. The monthly distribution amount to be distributed for each of the last six months of 2001 will be calculated as one-twelfth of the amount obtained by amortizing the aggregated account balances of IRA 1 and IRA 2 as of June 30, 2001, over a number of years equal to your life expectancy in 2001, using an interest rate equal to 120 percent of the annual federal mid-term rate in effect for July 2001. For subsequent years, the monthly distribution amount will be calculated as one-twelfth of the amount obtained by amortizing the aggregated account balances of IRA 1 and IRA 2 as of December 31 of the prior year over the number of years equal to your applicable life expectancy (using your age attained in the year for which the distributions are calculated), using an interest rate equal to 120 percent of the federal mid-term rate in effect for January of the distribution year. All

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distributions will be taken from IRA 1 or IRA 2, or from both IRA 1 and IRA 2, and only from these accounts.

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.

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 monthly periodic payments described in the ruling request, as modified, is to calculate an end-of-year annual distribution amount, which is then divided by twelve to obtain a monthly distribution amount. Because distributions of your benefits under the section 401(k) plan and the cash balance plan are not expected until after the first quarter of 2001, monthly distributions from IRAs 1 and 2 for 2001 will not commence until July 2001, and only six monthly distributions will be paid in 2001. The monthly distribution amount for 2001 will be calculated as one-twelfth of the end-of-year annual distribution amount obtained by amortizing the aggregated account balances of IRA 1 and IRA 2 as of June 30, 2001, over a number of years equal to your life expectancy, obtained from Table V of section 1.72-9 of the regulations (set forth in part in Table I of Appendix E of IRS Publication 590) using your age attained in 2001, at an assumed interest rate equal to 120 percent of the annual federal mid-term rate (used for purposes of Code section 1274(d)) in effect for July 2001. For subsequent years, the monthly distribution amount will equal one-twelfth of the end-of-year annual distribution amount obtained by amortizing the aggregated account balances of IRA 1 and IRA 2 as of December 31 of the prior year over a number of years equal to your life expectancy (obtained from Table V of section 1.72-9 of the regulations (currently set forth in part in Table I of Appendix E of IRS Publication 590), using your age attained in the year for which distributions are calculated), using an assumed interest rate equal

to 120 percent of the annual federal mid-term rate in effect for January of the year for which distributions are calculated. All monthly distribution amounts will be taken out of IRA 1 or IRA 2, or from both IRA 1 and IRA 2, and only from these IRAs.

Conclusion

The life expectancy and 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 life expectancy 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

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