Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

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Date:
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In re: Request for ruling on behalf of

Taxpayer C =

This letter is in response to your request, dated November 15, 1999, in which you asked for a ruling on behalf of Taxpayer C as to whether certain proposed distributions from an individual retirement account (IRA) owned by Taxpayer C 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 telephone calls with of our office on January 27, 2000, and February 16, 2000, and in your letter dated January 31, 2000.

According to the facts as stated, Taxpayer C is the owner of two IRAs (IRA 1 and IRA 2). After transferring funds from IRA 1 to IRA 2 on or before October 14, 1999, Taxpayer C decided to start taking annual distributions from IRA 2. Taxpayer C would like to avoid the tax imposed on premature distributions by Code section 72(t)(1) by calculating the annual distribution amount using one of the methodologies described in Notice 89-25, 1989-1 C.B. 662, for calculating substantially equal periodic payments. The annual distribution amount for 2000 will be calculated by dividing the account balance of IRA 2 as of April 30, 2000, by an annuity factor which is the cost of an annual $1 per year life annuity beginning at age 48. The annuity factor will be calculated using commutation functions based on the UP-1984 Mortality Table where an interest rate is assumed equal to 120 percent of the applicable annual federal long-term rate in effect for the month of May 2000. The annual distribution amount will be recalculated each year by dividing the account balance of IRA 2 as of April 30 by the applicable annuity factor, calculated in the same manner (except for later ages). All distributions will be taken from IRA 2.

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Ruling Requested

Based on these facts, the following ruling has been requested on behalf of Taxpayer C.

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. The life expectancies, mortality table, 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 high interest rate, unreasonable life expectancies, or an unreasonable mortality table).

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 was published on March 20, 1989, and provided 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 annual payment for the year 2000 by dividing the account balance as of April 30, 2000, of IRA 2 by an annuity factor which is the cost of a $1 per year life annuity beginning at age 48, with such annuity factor calculated using commutation functions based on the UP-1984 Mortality Table where an interest rate is assumed equal to 120 percent of the applicable annual federal long-term rate (used for purposes of Code section 1274) in effect for the month of May 2000. For subsequent years, the annual distribution amount will be calculated by dividing the account balance of IRA 2 as of April 30 of the distribution year by an annuity factor which is the cost

of a $1 per year life annuity commencing at the age attained by Taxpayer C in the distribution year, with such annuity factor calculated using commutation functions based on the UP-1984 Mortality Table where an interest rate is assumed equal to the 120 percent of the applicable annual federal long-term rate (used for purposes of Code section 1274) in effect for the month of May of the distribution year. All annual distribution amounts will be taken from IRA 2.

Conclusion

The life expectancies, mortality table, 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 high interest rate, unreasonable life expectancies, or unreasonable mortality table).

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.

Sincerely yours,

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