Internal Revenue Service

Significant Index No. 72.20-04

Department of the Treasury

Washington, DC 20224 200122048

Contact Person:

Telephone Number:

In Reference to:

T:EP:RA:T:A2

Date:

MAR 08 2001

In re: Request for ruling on behalf

Taxpayer K =

This letter is in response to your request on behalf of Taxpayer K, dated August 17, 2000, in which you asked for a ruling as to whether certain proposed distributions from an individual retirement account (IRA B) owned by Taxpayer K 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 telephone calls with of our office on November 15, 2000, January 31, 2001, and on February 1, 2001, to clarify the methodology used to calculate distributions.

According to the facts as stated, Taxpayer K participated in a plan described in section 401(k) of the Code, sponsored by Taxpayer K's employer. After Taxpayer K ceased employment with the employer on June 30, 2000, Taxpayer K's benefit under the employer's section 401(k) plan was transferred in a direct rollover to a newly established IRA (IRA A) owned by taxpayer K. A portion of IRA A's balance was subsequently transferred on August 21, 2000, to a second IRA, IRA B, which was established solely for the purpose of receiving such amount. Taxpayer K attained age 41 in 2000. Taxpayer K would like to start receiving quarterly distributions from IRA B, beginning on October 1, 2000, and would like to avoid the 10 percent tax imposed on premature distributions under Code section 72(t)(1) by taking distributions in the form of substantially equal periodic payments, as described in section 72(t)(2)(A)(iv) of the Code. The quarterly distribution amount for 2000 was calculated by dividing the account balance of IRA B as of August 21, 2000, by an annuity factor which is the present value of a one dollar per year annuity, paid in quarterly installments of 1/4 of a dollar, and commencing at age 41. The annuity factor is calculated using commutation functions derived from the UP-1984 Mortality Table where an interest rate of 7 percent is used. Once such quarterly payments commence, the same amount will be distributed for each quarter of subsequent years from IRA B, and only from IRA B.

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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.

Annlicable 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 3 1, 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)(l) 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 59 112, 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 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 quarterly periodic payments described in the ruling request, as modified, is to calculate a quarterly distribution amount for 2000 by dividing the account balance of IRA B as of August 21, 2000, by an annuity factor that is the cost of a one dollar per year life annuity, paid in quarterly installments of one-fourth of a dollar, commencing at age 41. The annuity factor is calculated using commutation functions derived from the UP-1984 Mortality Table, using an interest rate of 7 percent. Only one quarterly distribution will be paid in 2000, and the same quarterly distribution amount will be distributed each subsequent quarter thereafter. All distributions will be taken from IRA B, and only from IRA B.

Conclusion

The 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 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.

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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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