Internal Revenue Service

Department of the Treasury

Washington, DC 20224

200119060

UICs: 72.20-00
72.20-04

Contact Person:

Telephone Number:

In Reference to:

T:EP:RA:T3

Date:

FEB 13 2001

LEGEND:

Taxpayer A:

IRA U:

IRA V:

IRA W:

IRA X:

IRA Y:

IRA Z:

Date 1:

Date 2:

Date 3:

Sum 1:

Dear Mr. :

This is in response to the , letter submitted on your behalf by your authorized representative, as amended by correspondence dated , in which you, through your authorized representative, request several letter rulings under sections 72(t)(2)(A)(iv), and 72(t)(4) of the Internal Revenue Code. The following facts and representations support your ruling request.

Taxpayer A, whose date of birth was Date 1, 1945, and who is currently 55 years of age, maintains five (5) individual retirement arrangements (IRAs), IRAs U through Y, in his name. IRA W was established by means of a trustee-to-trustee transfer of a portion of the amounts standing in IRA V on Date 2, 1999. Beginning in calendar year 1999, Taxpayer A began receiving distributions from his IRA W using the "annuitization (third) method" referenced in Notice 89-25, 1989-1 C.B. 662, with an interest rate assumption of 7.3%. Your authorized representative has asserted on your behalf, that the distribution stream from IRA W was intended to comply with Code section 72(t)(2)(A)(iv).

336

During calendar year 2001, Taxpayer A intends to create an additional IRA, IRA Z, which will hold amounts currently standing in IRA V. IRA Z will be created by means of a trustee-to-trustee transfer from IRA V of assets in an amount approximating Sum 1. Taxpayer A will then, during calendar year 2001, initiate a series of payments from IRA Z, which series is intended to comply with the requirements of Code section 72(t)(2)(A)(iv). Taxpayer A will not cease said payments prior to the date permitted under Code section 72(t)(4). Your authorized representative has asserted, on your behalf, that the series of payments will be calculated using the "annuitization (third) method" referenced in Notice 89-25, and the interest rate assumed will be 8%. Your authorized representative has also asserted, on your behalf, that the 8% interest rate is 130% of the Long-Term AFR for December, 2000, as rounded up from the actual rate of 7.81%. He also asserts that Taxpayer A's IRA V has attained an actual rate of return during the previous five years which exceeds 8 percent.

Taxpayer A will attain age 59 ½ on Date 3, 2004.

Based on the above, Taxpayer A requests the following letter rulings:

(1) that the proposed method of determining periodic payments from Taxpayer A's IRA Z results in substantially equal periodic payments within the meaning of Code section 72(t)(2)(A)(iv) and that, accordingly, such payments will not be subject to the additional tax imposed by Code section 72(t)(1) unless the requirements of Code section 72(t)(4) are not met; and

(2) that the requirements of Code section 72(t)(4) will be met if Taxpayer A begins to receive annual payments from IRA Z during 2001 (the year IRA Z is established), and continues to receive substantially equal payments computed in accordance with the method described above annually from IRA Z each year until at least the year required by Code section 72(t)(4).

With respect to the ruling requests, Code section 408(d) 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 Code section 72.

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

Code section 72(t)(1) provides for the imposition of an additional 10 percent income tax on early distributions from qualified plans, including IRAs. The additional tax is imposed on that portion of the distribution which is includible in gross income.

Code section 72(t)(2)(A)(i) provides that section 72(t)(1) shall not apply to distributions which are made on or after the date on which the employee attains age 59 1/2.

Code section 72(t)(2)(A)(iv) provides that Code 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 or her beneficiary.

Code section 72(t)(4) 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.

In the absence of regulations on Code section 72(t), guidance with respect to the exception to the Code section 72(t)(1) tax on premature distributions found at section 72(t)(2)(A)(iv) was provided by Notice 89-25, 1989-1 C.B. 662. Question and Answer-12 of Notice 89-25 provides three methods which may be used for determining substantially equal periodic payments for purposes of section 72(t)(2)(A)(iv). 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.

One method of determining substantially equal annual payments described in Q&A-12 would be to use a method acceptable for purposes of calculating the minimum distributions required under Code section 401(a)(9). For distributions to be made from an individual account, this could be accomplished by dividing the account balance as of a given date by the life expectancy (or joint and last survivor expectancy of the account owner and beneficiary, if applicable) and this would be the amount to be distributed for the first year. The life expectancies to be used are found in Table V (one life) or Table VI (two lives) of section 1.72-9 of the Income Tax Regulations. Where a one-time calculation is done, the same amount would be distributed in subsequent years.

A second method described in Q&A-12 determines an annual distribution by amortizing the taxpayer's account balance over a number of years equal to the life expectancy of the account owner or the joint life and last survivor expectancy of the account owner and beneficiary at an interest rate that does not exceed a reasonable interest rate on the date payments commence. The resulting payment is the amount to be distributed each year. Again, the life expectancies to be used are found in Table V (one life) or Table VI (two lives) of section 1.72-9 of the regulations.

The third method described in Q&A-12 of Notice 89-25 determines substantially equal annual payments by dividing the account balance by an annuity factor (the present value of an annuity of $1 per year beginning at the taxpayer's age attained in the first distribution year and continuing for the life of the taxpayer) with such annuity factor derived using a reasonable mortality table and using an interest rate that does not exceed a reasonable interest rate on the date payments commence. The annuity factor is calculated using commutation functions derived from a particular mortality table where a particular interest rate is assumed. Because an infinite number of interest rates could be assumed, the number of possible tables of possible commutation functions is infinite. In the example in Q&A-12 of Notice 89-25, the annuity

factor is derived using commutation functions based on UP-1984 Mortality Table where an interest rate of 8 percent is assumed.

The account balance used in the determination of the substantially equal periodic payments is generally the balance of the IRA from which the distribution will be made. If a taxpayer owns more than one IRA, any combination of his or her IRAs may be taken into account in determining the distributions by aggregating the account balances of those IRAs. The specific IRAs taken into account are part of the method of determining the substantially equal periodic payments which, if modified in a way described in Code section 72(t)(4), will expose the taxpayer to increased taxes. It is noted that if two or more IRAs are used in determining the substantially equal periodic payments, the distributions need not be made from all of the pertinent IRAs. The distributions may be made solely from one of the IRAs, or from a combination of the IRAs.

Under the methodology proposed by Taxpayer A, only the newly established IRA (IRA Z) will be used to determine the substantially equal payments. Based on Taxpayer A's date of birth, Date 1, 1945, he will attain age 59 ½ on Date 3, 2004. Furthermore, if he begins to receive annual periodic payments from IRA Z during calendar year 2001, he will receive his fifth periodic payment during calendar year 2005.

It is represented that Taxpayer A's periodic payments from IRA Z will be based on an interest rate assumption of 8 percent which, based on the representations made with respect to this ruling request, is not unreasonable. Furthermore, there is no need for periodic payments from IRA Z to be aggregated with payments from any other IRA maintained in the name of Taxpayer A, referenced herein, for said payments to fall within the exception to Code section 72(t)(1) found at Code section 72(t)(2)(A)(iv). Finally, although Taxpayer A is currently receiving distributions from IRA W which distributions, it is represented, conform to the requirements of Code section 72(t)(2)(A)(iv), the commencement of distributions from IRA Z will not result in a modification, within the meaning of Code section 72(t)(4), to the stream of payments currently being paid from IRA W.

Taxpayer A will turn age 59 1/2 on Date 3, 2004. Therefore, if Taxpayer A receives at least five substantially equal annual payments from IRA Z (at least one during each of the years 2001, 2002, 2003, 2004, and 2005), and does not otherwise modify his IRA Z distribution scheme (i.e. make additional withdrawals from the IRA, etc.) until at least after 2005, the requirements of Code section 72(t)(4) with respect to IRA Z and the payments made therefrom will be satisfied.

Therefore, based on the above, with respect to the second and third ruling requests, we conclude:

(1) That the proposed method of determining periodic payments from Taxpayer A's IRA Z results in substantially equal periodic payments within the meaning of Code section 72(t)(2)(A)(iv) and that, accordingly, such payments will not be subject to the additional tax imposed by Code section 72(t)(1) unless the requirements of Code section 72(t)(4) are not met; and

(2) that the requirements of Code section 72(t)(4) will be met if Taxpayer A begins to receive annual payments from IRA Z during 2001 (the year IRA Z is established), and continues to receive substantially equal payments computed in accordance with the method described above annually from IRA Z each year until at least the year 2005.

This ruling letter is based on the assertions of Taxpayer A's representative that Taxpayer A's IRA Z, which Taxpayer A proposes to set up to receive the amounts transferred from his IRA V, and IRA V, either have met or will meet the requirements of Code section 408(a) at all times relevant thereto. It takes no position as to whether the payment stream from IRA W complies with the requirements of Code section 72(t)(2)(A)(iv).

Pursuant to a power of attorney on file in this office, a copy of this letter ruling is being sent to your authorized representative.

Sincerely yours,

Frances V. Sloan

Frances V. Sloan
Manager, Employee Plans
Technical Group 3
Tax Exempt and Government
Entities Division

Enclosures:

Deleted copy of ruling letter
Form 437