200033048

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

UIL: 72.20-00
72.20-04

Contact Person:

Telephone Number:

In Reference to:
T:EP:RA:T3

Date:

MAY 23 2000

LEGEND:

Taxpayer A:

Month 1:

*Month 2:

Amount 1:

Amount 2:

Amount 3:

Dear

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

Taxpayer A, who is approximately 51 years of age, will attain age 59 1/2 during Month 1, 2008. Taxpayer A presently maintains an individual retirement arrangement (IRA) described in Code section 408(a) from which she has been, and is receiving, a monthly distribution of Amount 1. The monthly distributions from Taxpayer A's IRA began in Month 2, 1995, and were intended to comply with the requirements of Code section 72(t)(2)(A)(iv). The amount presently remaining in Taxpayer A's IRA is approximately Amount 2.

During calendar year 2000, Taxpayer A intends to receive a distribution of Amount 3 from her IRA. Amount 3 is approximately seven and one half times the amount of the annual distribution that Taxpayer A has been receiving from her IRA. This distribution will result in additional taxes pursuant to Csde section 72(t)(4)(A).

During calendar year 2001, Taxpayer A will begin to receive a second series of monthly distributions from her IRA. Her initial distribution will be based on the account balance remaining in the IRA as of the last day of the month immediately preceding the month of distribution. Taxpayer A's second series of monthly payments will be based on annual payments determined by amortizing her IRA account balance over a number of years equal to her life expectancy adjusted in accordance with changes to the consumer price index.

301

200033048

Taxpayer A will continue to receive her second series of periodic payments until at least the later of her attainment of age 59 ½ or five years from the date said payments commenced.

With respect to Taxpayer A's proposed payments, your authorized representative has represented that the consumer price index for the preceding five years was as follows:

1995 (2 months)	151.0
1995 (12 months)	154.1
1996 (12 months)	159.1
1997 (12 months)	161.8
1998 (12 months)	164.4
1999 (12 months)	164.7

Based on the above facts and representations, you, through your authorized representative, request the following letter rulings:

1. That Taxpayer A's second series of periodic payments, to commence in calendar year 2001, will qualify for the exception found in Code section 72(t)(2)(A)(iv) to the ten percent additional income tax imposed by Code section 72(t)(1); and

2. that Taxpayer A's periodic payments may increase in accordance with the increase in the consumer price index.

With respect to your ruling requests, 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), which was added to the Internal Revenue Code by the Tax Reform Act of 1986 (TRA' 86), effective generally for taxable years beginning after December 31, 1986, 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

302

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), Notice 89-25, published on March 20, 1989, provided guidance with respect to the exception to the Code section 72(t)(1) tax on premature distributions provided under section 72(t)(2)(A)(iv). 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.

The 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. 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 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.

With respect to your ruling requests, the payment which Taxpayer A intends to receive in calendar year 2000 in the sum of Amount 3 will be disproportionately larger than the monthly and annual payments which Taxpayer A has been receiving since Month 2. Thus, this payment substantially modifies her series of periodic payments as that concept is used in Code section 72(t)(4).

The issue presented in this ruling request is whether a taxpayer may initiate a new series of periodic payments and, thus, qualify for the exception to the ten percent additional income tax imposed by Code section 72(t)(1) found in Code section 72(t)(2)(A)(iv) after an earlier series of periodic payments which qualified for the exception has been substantially modified so as to result in income tax recapture pursuant to Code section 72(t)(4).

The Internal Revenue Code does not limit a taxpayer to one series of periodic payments. Furthermore, Notice 89-25 does not provide that a taxpayer is limited to one series of periodic payments. However, in order to avoid having one or more payment of a second, or subsequent, series of periodic payments from being treated as part of the payment which substantially modified an earlier series of periodic payments, it is necessary that the second series of periodic payments begin in a calendar year subsequent to the calendar year in which the payment which gives rise to the application of Code section 72(t)(4) is made.

203

With further reference to your ruling requests, as noted above, Notice 89-25 provides that a method of computing annual, periodic, payments that will comply with the requirements of Code section 72(t)(2)(A)(iv) consists of a taxpayer's amortizing her IRA account balance over her life expectancy at a reasonable interest rate.

In this case, Taxpayer A intends to amortize her IRA account balance, as of the last day of the calendar month immediately preceding the calendar month in which the initial payment of her series is made, over her life expectancy using a rate of growth equivalent to the rate of increase in the consumer price index for that year. This proposed method conforms with the second method found in Q&A-12 of Notice 89-25.

Thus, with respect to your ruling requests, we conclude as follows:

1. That Taxpayer A's second series of periodic payments, to commence in calendar year 2001, will qualify for the exception to the ten percent additional income tax imposed by Code section 72(t)(1) found in Code section 72(t)(2)(A)(iv); and

2. that Taxpayer A's periodic payments may increase in accordance with the increase in the consumer price index.

This ruling letter is based on the assumption that Taxpayer A's IRA will comply with the requirements of Code section 408(a) at all times relevant thereto. It also assumes that Taxpayer A's second series of payments which are intended to comply with the requirements of Code section 72(t)(2)(A)(iv) will commence in a calendar year subsequent to the calendar year in which she will receive her Amount 3 payment.

This ruling is directed solely to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

200033048

Pursuant to a power of attorney on file in this office, the original 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 letter ruling
Form 437

305