Internal Revenue Service Department of the Treasury 200027062

Significant Index No. 0072-0400

Washington, DC 20224

Person to Contact:

Telephone Number:

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Date: APR 14 2000

Taxpayer A=
IRA Z=

This is in reply to your authorized representative's letter dated February 10, 2000 requesting a ruling on the federal tax consequences of certain transactions involving an individual retirement arrangement (IRA). It is proposed that distributions from IRA Z to Taxpayer A be considered as being distributed as periodic payments as described in section 72(t)(2)(A)(iv) of the Internal Revenue Code.

The following facts, representations and documents have been submitted in support of the request:

Taxpayer A has a date of birth of October 3, 1946. Distributions from IRA Z began in January 2000. At that time, Taxpayer A was aged 53 year and four months. As of November 30, 1999, IRA Z had an account balance of $1,484,835.61.

As of January 2000, the life expectancy of Taxpayer A is 30.4 years. This is based on the single-life expectancy Table V of section 1.72-9 of the Income Tax Regulations. Taxpayer A proposes to receive 365 equal monthly payments from IRA Z of $8,858.89 each.

Based on the above information, you requested the following ruling:

> The use of an interest rate equal to 6% and the use of the value of IRA Z as of November 30, 1999 (with payments commencing January 2000) are permitted. Therefore, annual distributions of $106,306.61, paid in monthly installments, will be considered substantially equal payments within the meaning of section 72(t)(2)(A)(iv) of the Code.

<u>Law</u>

Section 408(a) of the Code provides, in pertinent part, that for purposes of section 408, the term "individual retirement account" means a trust created or organized in the United States for the exclusive benefit of an individual or his beneficiaries, but only if the written governing instrument creating the trust meets certain requirements specified under section 408.

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Section 408(d) of the Code establishes the general requirements for the tax treatment of distributions from IRAs while section 72(t) sets forth the rules regarding the 10 percent additional tax on early distributions from IRAs.

Section 408(d)(1) of the Code states that, except as otherwise provided in this subsection, any amount paid or distributed out of an IRA shall be included in gross income by the payee or distributee, as the case may be, in the manner provided under section 72.

Section 72 of the 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 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 which 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 72(t)(4)(B) of the Code defines "deferral period" as the period beginning with the taxable year in which (without regard to paragraph (2)(A)(iv)) the distribution would have been includible in gross income and ending with the taxable year in which the modification described in subparagraph (A) occurs.

Notice 89-25, 1989-1 C.B. 203, provides three methods of determining substantially equal periodic payments for purposes of section 72(t)(2)(A)(iv) of the Code. They are:

(1) The IRA balance is divided by the life expectancy to determine an amount that satisfies the minimum distribution rules of section 401(a)(9).

(2) The IRA account balance is amortized over the number of years equal to the life expectancy of the account owner with life expectancies determined in accordance with section 1.401(a)(9)-1 of the Income Tax Regulations (Proposed) at an interest rate that does not exceed a reasonable interest rate on the date payments commence.

(3) Distributions are computed by dividing the account balance by an annuity factor determined using a reasonable mortality table and reasonable interest rate.

Analysis

Taxpayer A has elected to use the second method of Notice 89-25 to determine the amount of the distributions. Taxpayer A has chosen to use an interest rate of 6%. The life expectancy of Taxpayer A, as of January 2000, based on Table V of section 1.72-9 of the regulations, is 30.4.

For January 2000, the Federal Mid-Term Rate was 6.21%; 120% of the Federal Mid-Term Rate was 7.47%. In general, for purposes of determining substantially equal payments, a rate that does not exceed 120% of the Federal Mid-Term Rate is reasonable.

Conclusion

Accordingly, we conclude that the use by Taxpayer A of an interest rate of 6% and a life expectancy of 30.4 years, in accordance with the second method of Notice 89-25, are reasonable. In addition, the use of the November 30, 1999 IRA Z account balance is reasonable. Therefore, the use by Taxpayer A of these assumptions and the resulting $106,306.68 annual distribution (distributed monthly) constitutes substantially equal payments within the meaning of section 72(t)(2)(A)(iv) of the Code.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent. A copy of this letter is being sent to your authorized representative pursuant to a Form 2848 (Power of Attorney) on file with this case.

Sincerely,

James E. Holland, Jr.

James E. Holland, Jr., Manager
Employee Plans Actuarial Group 1
Tax Exempt and Government Entities Division