



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

200943044

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

JUL 28 2009

Uniform Issue List: 72.20-04

SE: T: EP: RA: T1

Legend:

- Taxpayer A =
- Trust B =
- Individual C =
- Trust D =
- Date E =
- Date F =
- Date G =
- IRA X =
- IRA Y =
- IRA Z =

Dear:

This letter is in response to a request for a letter ruling dated ***** submitted on your behalf by your authorized representative in which you request a ruling as to whether a proposed method of calculating distributions from IRA X owned by Trust B 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") on early distributions, and whether the method for determining such distributions from IRA X will not be subject to the 10 percent additional tax on early distributions under section 72(t) of the Code regardless of whether similar distributions are made from IRA Y (or any other individual retirement account which is maintained for Taxpayer A's benefit) and the account balance of IRA Y (or any other

individual retirement account which is maintained for Taxpayer A's benefit) need not be considered when calculating the amounts of annual distributions from IRA X.

The following facts and representations have been submitted under penalty of perjury in support of the rulings requested:

Individual C established IRA Z during his lifetime to receive lump sum distributions from his employer's retirement plan. Prior to his death, Individual C executed a trust agreement ("Trust D") which was partially funded by IRA Z.

Individual C died on Date E, at which time Trust D became irrevocable, and pursuant to the beneficiary designation for IRA Z, the undistributed balance of IRA Z remaining at Individual C's death became payable to Trust D. The undistributed balance of IRA Z in Trust D and the other assets of Trust D were divided into separate trusts for the benefit of certain of Individual C's descendants, including Taxpayer A. Trust B received a 12½% interest in IRA Z.

On Date F, the Trustees of Trust B elected to treat the entire share of the undistributed balance of IRA Z payable to Trust B as a separate IRA (IRA Y) which is subject to the distribution requirements of section 408(a)(6) of the Code then in effect and section 1.408-2(b)(7)(ii) of the Treasury Regulations (the "regulations").

In a private letter ruling dated Date G, the Internal Revenue Service ("Service") ruled that under section 408 of the Code in effect on the date of Individual C's death, as applied with respect to Trust B, Taxpayer A is the individual for whose benefit IRA Y is maintained for purposes of determining (a) when distributions from IRA Y must be made or commence, (b) the measuring life for installment distributions from IRA Y, and (c) the applicability of the additional premature withdrawal tax with respect to IRA Y.

The Trustees of Trust B propose to divide IRA Y into two separate individual retirement accounts. This will be accomplished by transferring a portion of the assets held by IRA Y in an investment account into a new individual retirement account (IRA X) which will also continue to be owned by Trust B.

Following such division, the Trustees of Trust B propose to begin making annual distributions from IRA X to Taxpayer A, age 34. The proposed annual distribution amount will be determined each year by dividing the account balance of IRA X as of December 31 of the prior year by an annuity factor which is equal to the present value of a \$1 per year single-life annuity with such annuity factor (based on Taxpayer A's age in that distribution year) calculated using an assumed interest rate equal to 120% of the federal mid-term rate as of December 31 of the prior year and the mortality table in Appendix B of Revenue Ruling 2002-62. Although the annual distribution amount for each year will be recalculated, the method by which the amount will be determined will remain the same from year to year.

Based on the above facts and representations, you request that the Service rule that:

- (1) the method described above for determining the annual distributions from IRA X constitutes a series of substantially equal periodic payments pursuant to Revenue Ruling 2002-62 and thus will not be subject to the 10% additional tax on early distributions under section 72(t) of the Code, and
- (2) the method for determining the annual distributions from IRA X will not be subject to the 10% additional tax noted in (1) regardless of whether similar distributions are made from IRA Y (or any other individual retirement account which is maintained for Taxpayer A's benefit), and the account balance of IRA Y (or any other individual retirement account which is maintained for Taxpayer A's benefit) need not be considered when calculating the amounts of the annual distributions from IRA X, and
- (3) the generation-skipping transfer tax provisions do not apply to Trust B pursuant to section 1433(b)(2) of the Tax Reform Act of 1986 and section 26.2601-1(b)(1)(i) of the regulations, and neither the proposed transfer of part of the Investment Account of IRA Y to IRA X nor the proposed annual distributions from IRA X to Trust B and from Trust B to Taxpayer A will cause Trust B to become subject to the generation-skipping transfer tax provisions pursuant to section 26.2601-1(b)(4) of the regulations.

Section 408(a)(6) of the Code, prior to its amendment by section 521(b) of the Deficit Retirement Act of 1984 ("DEFRA"), provided that the entire interest of an individual for whom an individual retirement account is maintained must be distributed to the individual not later than the close of the taxable year in which such individual attains age 70½ or must be distributed, commencing before the close of such taxable year, in accordance with regulations prescribed by the Secretary, over (a) the life of such individual or the lives of such individual and his spouse, or (b) a period not extending beyond the life expectancy of such individual or the life expectancy of such individual and his spouse.

Section 408(a)(7) of the Code, prior to its amendment by section 521(b) of DEFRA, provided that if an individual for whose benefit an individual retirement account was maintained died before such individual's entire interest had been distributed to him or her, the entire interest (or the remaining part of such interest if distribution had commenced) must, within five years after such individual's death, be distributed to or applied to purchase an immediate annuity for the beneficiary thereof.

Section 1.408-2(b)(7)(ii) of the regulations permitted a beneficiary of a decedent's individual retirement account to treat his or her interest to be subject to the distribution rules of section 408(a)(6) of the Code in effect prior to its amendment by section 521(b) of DEFRA.¹

Section 408(d)(1) of the Code provides, except as otherwise provided in section 408(d), 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 of the Code.

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)(1) of the Code 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)(i) of the Code provides that section 72(t)(1) shall not apply to distributions made on or after the date on which the employee attains age 59½.

Section 72(t)(2)(A)(iv) of the Code provides that section 72(t)(1) shall not apply to distributions that 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 joint lives (or joint life expectancies) of such employee and his designated 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 59½, 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 72(t)(5) of the Code provides that for purposes of section 72(t), the term "employee" includes any participant, and in the case of an individual retirement plan, the individual for whose benefit such plan was established.

¹ Thus, the regulations under section 408(a)(7) of the Code allow a beneficiary of an individual who died before the effective date of section 521(b) of DEFRA (i.e., years beginning after December 31, 1984), to defer distributions from the individual retirement account until such beneficiary attained age 70½, as provided in section 408(a)(6) of the Code then in effect. In this context, the beneficiary becomes the individual for whose benefit the individual retirement account is maintained for purposes of the distribution rules for individual retirement accounts under section 408 of the Code.

Section 1.401(a)(9)-9 of the 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 (Q&A-1) and joint life and last survivor expectancies for two lives (Q&A-3).

Notice 89-25, 1989-1 C. B. 662, which was published on March 20, 1989, 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 of determining substantially equal periodic payments for purposes of section 72(t)(2)(A)(iv) of the Code.

Revenue Ruling 2002-62, 2002-42 I.R.B. 710, which was published on October 21, 2002, modifies Q&A-12 of Notice 89-25. Rev. Rul. 2002-62 provides, among other things, that payments are considered to be substantially equal periodic payments within the meaning of section 72(t)(2)(A)(iv) if they are made in accordance with the required minimum distribution method, the fixed amortization method or the fixed annuitization method (the three methods described in Q&A-12 of Notice 89-25). The fixed annuitization method provides that the annual payment for each year is determined by dividing the account balance by an annuity factor that is the present value of an annuity of one dollar (\$1) per year beginning at the taxpayer's age and continuing for the life of the taxpayer (or the joint lives of the individual and beneficiary). The annuity factor is derived using the mortality table in Appendix B of Revenue Ruling 2002-62 and using the chosen interest rate. Under this method, the account balance, the annuity factor, the chosen interest rate and the resulting annual payment are determined once for the first distribution year and the annual payment is the same amount in each succeeding year.

Section 2.02 of Revenue Ruling 2002-62 contains rules that apply to each of the three methods of calculating a series of substantially equal periodic payments. Section 2.02 provides, in general, that payments will constitute a series of substantially equal periodic payments if the payments are determined by using: (a) the uniform lifetime table in Appendix A of Revenue Ruling 2002-62, the single life expectancy table in section 1.401(a)(9)-9, Q&A-1 of the regulations, or the joint and last survivor table in section 1.401(a)(9)-9, Q&A-3 of the regulations, (b) an interest rate that is not more than 120 percent of the federal mid-term rate, and (c) a reasonable manner of determining the account balance,

In this case, Taxpayer A proposes to determine the annual payments from IRA X in accordance with the fixed annuitization method as described in section 2.01 (c) of Revenue Ruling 2002-62, except that rather than receiving a fixed annual payment, the amount of the annual payment will be recalculated each year. The annual distribution amount will be determined by dividing the IRA X account balance as of December 31 of the prior year by an annuity factor which is equal to the present value of a \$1 per year single-life annuity with such annuity factor (based on Taxpayer A's age in that distribution year) calculated using an assumed interest rate equal to 120 percent of the

federal mid-term rate as of December 31 of the prior year, and the mortality table in Appendix B of Revenue Ruling 2002-62.

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 high interest rate or an unreasonable high mortality table).

Accordingly, with respect to ruling request number one, we conclude that the proposed method (as modified) of determining periodic payments 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 ten percent additional tax of section 72(t) unless the requirements of section 72(t)(4) are not met.

Section 72(t)(2)(A)(iv) of the Code does not require that plans be aggregated to calculate a series of substantially equal periodic payments. Accordingly, with respect to ruling request number two, we conclude that the annual distributions from IRA X calculated using the method described above are not subject to the ten percent additional tax of section 72(t)(1) regardless of whether similar distributions are made from IRA Y (or any other individual retirement account which is maintained for Taxpayer A's benefit), and that the account balance of IRA Y (or any other individual retirement account which is maintained for Taxpayer A's benefit) need not be considered when calculating the amounts of the annual distributions from IRA X necessary under section 72(t)(2)(A)(iv).

At this point, it is Taxpayer A's option to begin receiving substantially equal periodic payments that are based on the proposed method described above. Please note, however, that pursuant to Code section 72(t)(4), the substantially equal periodic payments must not be subsequently modified (other than by reason of death or disability) before Taxpayer A attains age 59½, in order for Taxpayer A to avoid imposition of the ten percent additional tax of section 72(t)(1).

Since ruling request number three falls within an area of the Code that is outside the jurisdiction of Employee Plans Technical, this ruling is being handled by the Office of Associate Chief Counsel (Passthroughs and Special Industries), CC:PSI:FO.

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

A copy of this letter has been sent to your authorized representative in accordance with a power of attorney on file in this office.

If you wish to inquire about this ruling, please contact *****
(Government Identification Number **-*****) by phone at (***) ***-**** or by fax at (***)
-*. Please address all correspondence to SE:T:EP:RA:T1.

Sincerely,

Carlton A. Watkins

Carlton A. Watkins, Manager
Employee Plans Technical Group 1

Enclosures:

- ▶ Deleted copy of ruling letter
- ▶ Notice of Intention to Disclose