MEMO# 12533

August 25, 2000

IRS PRIVATE LETTER RULING CLARIFIES "SUBSTANTIALLY EQUAL PERIODIC PAYMENT" METHOD FOR EARLY IRA DISTRIBUTIONS

[12533] August 25, 2000 TO: PENSION COMMITTEE No. 63-00 RE: IRS PRIVATE LETTER RULING CLARIFIES “SUBSTANTIALLY EQUAL PERIODIC PAYMENT” METHOD FOR EARLY IRA DISTRIBUTIONS The Internal Revenue Service recently issued a private letter ruling that clarifies the “substantially equal periodic payments” exception to the Code section 72(t) early withdrawal penalty applicable to qualified plans and IRAs. The Service ruled that a taxpayer’s proposed distribution method from a traditional IRA commencing prior to attainment of age 59½ qualifies under the exception, even though the payment amounts would vary based on the IRA’s asset level for a given year and changing interest and life expectancy factors used to calculate the distribution amounts. In PLR 200031058, the Service addressed the following facts. The taxpayer proposed to begin annual withdrawals from a traditional IRA beginning in 2000 at the age of 56. For 2000, the annual distribution amount would be determined by dividing the account balance of the IRA as of December 31, 1999, by an annuity factor (i.e., the cost of an annuity of one dollar per year beginning at age 56 and continuing for the taxpayer’s life). The annuity factor would be calculated using commutation functions derived from the UP-1984 Mortality Table where an 8-percent interest rate is used. Beginning in 2001 and each year thereafter, the annual distribution amount would be determined by dividing the balance of the IRA as of December 31 of the prior year by an annuity factor (i.e., the cost of an annuity of one dollar per year beginning at the taxpayer’s age in the distribution year and continuing for the taxpayer’s life). The annuity factor would be calculated using commutation functions derived from the UP-1984 Mortality Table using an interest rate equal to 120 percent of the Mid-Term Applicable Federal Rate (AFR) for January of the distribution year. Under Code section 72(t)(2)(A)(iv), distributions are not subject to the 10-percent tax on pre-59½ withdrawals if they 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. To determine the distribution methods permissible under this exception, the Service looked to Notice 89-25, which provides three qualifying distribution methods. The third of these methods allows a taxpayer to calculate substantially equal annual payments by dividing the account balance by an annuity factor derived from a reasonable mortality table and a reasonable interest rate. 2The Service ruled that the taxpayer’s methodology is consistent with the third method provided in Notice 89-25 because it does not circumvent the requirements of sections 72(t)(2)(A)(iv) and 72(t)(4) (which prohibits substantial modifications to a

distribution method) through the use of an “unreasonable high interest rate or an unreasonable life expectancy.” Thus, distributions made pursuant to the proposed method would not be subject to the section 72(t) tax. Thomas T. Kim Assistant Counsel Attachment Attachment (in .pdf format)
