

MEMO# 2765

May 16, 1991

TAXPAYER CANNOT AVOID PREMATURE WITHDRAWAL PENALTY ON SYSTEMATIC PAYMENTS FROM VARIABLE ANNUITY

May 16, 1991 TO: PENSION MEMBERS NO. 19-91 RE: TAXPAYER CANNOT AVOID PREMATURE WITHDRAWAL PENALTY ON SYSTEMATIC PAYMENTS FROM VARIABLE ANNUITY

Individuals who withdraw funds from an IRA or other qualified retirement program prior to attaining age 59-1/2 generally incur a 10 percent federal tax penalty for premature withdrawal. The penalty does not apply to a distribution which is part of a series of substantially equal periodic payments made over the life or life expectancy of the taxpayer and the taxpayer's beneficiary. In a recent private letter ruling, a taxpayer proposed to invest in a variable annuity contract funded with mutual fund shares. The policy prospectus provided for a "Systematic Withdrawal Option" by which the taxpayer could surrender a specified dollar amount on a regular basis. The taxpayer requested a ruling that, in the event he purchases the variable annuity policy and later elects to use the Systematic Withdrawal Option, the 10 percent penalty on premature withdrawals would not apply if the payments are determined by amortizing the contract value of the policy over the taxpayer's remaining life expectancy. The taxpayer also represented that once the Systematic Withdrawal Option was selected, he would not change his election until after the taxpayer attained age 59-1/2. The Service ruled that the taxpayer could not avoid the 10 percent penalty. Under the taxpayer's policy, the exercise of the Systematic Withdrawal Option would not fix the pattern of future distributions because the taxpayer could change the distribution pattern with regard to amount and duration at his request. A copy of Private Ruling 9115041 is attached. We will keep you informed of related developments. W. Richard Mason Assistant Counsel - Pension Attachment