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PLR 9747039

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 sections 72(t)(2)(A)(iv), 72(t)(4), and 402(c) of the Internal Revenue Code. The following facts and representations support your ruling request.

Taxpayer A, whose date of birth was

***, has an accumulated account balance in Plan X, a profit-sharing plan containing a section 401(k) of the Internal Revenue Code feature, sponsored by his employer, Company W, attributable entirely to a rollover made from an earlier qualified profit-sharing plan maintained by Company W. The earlier profit-sharing plan terminated on or about July 15, 1992. At that time, Taxpayer A received a distribution of his entire interest in the profit-sharing plan and rolled over the taxable portion, in part, to a rollover individual retirement arrangement (hereinafter IRA Z) and the remainder to Plan X. Taxpayer A immediately began taking annual distributions of \$140,000 from IRA Z. These distributions have been determined by the Internal Revenue Service to be part of a series of substantially equal periodic payments within the meaning of Code section 72(t)(2)(A)(iv). Said IRA Z distributions are scheduled to continue until at least Taxpayer A's attainment of age 59-1/2 in the year 2001.

Taxpayer A intends to take a distribution of \$6,297,216 from Plan X. This distribution will take the form of a direct rollover to a newly established IRA (hereinafter IRA Y) in the name of Taxpayer A. Assets will be transferred in kind from Taxpayer A's self-directed rollover account in Plan X. Once IRA Y is established in 1997, Taxpayer A will immediately begin taking annual distributions of \$510,000 from it. Taxpayer A anticipates continuing to receive these annual distributions until he receives at least five annual \$510,000 distributions.

Taxpayer A's distribution from Plan X will be made in accordance with section 20.13 of Plan X. Furthermore, Taxpayer A's authorized representative has asserted on his behalf that Taxpayer A will not be receiving substantially equal distributions, at least annually, from Plan X over any of the periods described in Code section 402(c)(4).

Taxpayer A's proposed method for determining the annual periodic payments is to determine a beginning of year annual payment by amortizing the account balance on the date the IRA is established over a number of years equal to the 1997 single life expectancy of the account owner obtained from Table V of section 1.72-9 of the Income Tax Regulations as a whole number (without the decimal portion), assuming an interest rate of return equal to 7.59 percent. Under the

proposed method, the annual periodic payment, once determined, will not change. The interest rate is 120 percent of the federal mid-term rate for December, 1996.

Based on the above, Taxpayer A requests the following letter rulings:

(1) That Taxpayer A's proposed rollover from Plan X to Taxpayer A's newly established IRA (IRA Y) is an "eligible rollover distribution" within the meaning of Code section 402(c)(4) and, as such, the amount of such distribution transferred to IRA Y shall not be includible in Taxpayer A's taxable income for the taxable year in which distributed from Plan X;

(2) that the proposed method of determining periodic payments from Taxpayer A's IRA Y results in substantially equal periodic payments within the meaning of Code section 72(t)(2)(A)(iv) and that, accordingly, such payments will not be subject to the additional tax imposed by Code section 72(t)(1) unless the requirements of Code section 72(t)(4) are not met; and

(3) that the requirements of Code section 72(t)(4) will be met if Taxpayer A begins to receive \$510,000 annually from IRA Y during 1997 (the year IRA Y is established), and continues to receive \$510,000 annually from IRA Y each year until at least the year 2001.

With respect to the first ruling request, Code section 402(c)(1) provides that, if an employee transfers any portion of an eligible rollover distribution into an eligible retirement plan, the amount so transferred shall not be includible in income for the taxable year in which paid.

Code section 402(c)(4) provides that an "eligible rollover distribution" is a distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified trust; except that such term shall not include -

(A) any distribution which is one of a series of substantially equal periodic payments (not less frequently than annually) made -

(i) for the life (or life expectancy) of the employee or

the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or

(ii) for a specified period of 10 years or more, and

(B) any distribution to the extent such distribution is required under section 401(a)(9).

Code section 402(c)(8)(B) defines an eligible retirement plan to include, inter alia, an IRA described in Code section 408(a).

In this case, Taxpayer A, who has not attained age 70-1/2, proposes to receive the sum of \$6,297,216 from Plan X. Taxpayer A's authorized representative has asserted that his Plan X

distribution will not be one in a series of substantially equal payments made over one of the periods referenced in Code section 402(c)(4).

Therefore, based on the above, we conclude with respect to the first ruling request:

(1) That Taxpayer A's proposed rollover from Plan X to Taxpayer A's IRA Y is an "eligible rollover distribution" within the meaning of Code section 402(c)(4) and, as such, [sic] the amount of such distribution transferred to IRA Y shall not be includible in Taxpayer A's taxable income for the taxable year in which distributed from Plan X.

With respect to Taxpayer A's second and third ruling requests, Code section 408(d) provides that amounts paid or distributed out of an individual retirement plan must be included in gross income by the payee or distributee in the manner provided under Code section 72.

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 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.

One method of determining substantially equal annual payments described in Q&A-12 would be to use a method acceptable for purposes of calculating the minimum distributions required under

Code section 401(a)(9). For distributions to be made from an individual account, this could be accomplished by dividing the account balance as of a given date by the life expectancy (or joint and last survivor expectancy of the account owner and beneficiary, if applicable) and this would be the amount to be distributed for the first 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 Income Tax Regulations. Where a one-time calculation is done, the same amount would be distributed in subsequent years.

A 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. Again, 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 third method described in Q&A-12 of Notice 89-25 determines substantially equal annual payments by dividing the account balance by an annuity factor (the present value of an annuity of \$1 per year beginning at the taxpayer's age attained in the first distribution year and continuing for the life of the taxpayer) with such annuity factor derived using a reasonable mortality table and using an interest rate that does not exceed a reasonable interest rate on the date payments commence. The annuity factor is calculated using commutation functions derived from a particular mortality table where a particular interest rate is assumed. Because an infinite number of interest rates could be assumed, the number of possible tables of possible commutation functions is infinite. In the example in Q&A-12 of Notice 89-25, the annuity factor is derived using commutation functions based on UP-1984 Mortality Table where an interest rate of 8 percent is assumed.

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. If a taxpayer owns more than one IRA, any combination of his or her IRAs may be taken into account in determining the distributions by aggregating the account balances of those IRAs. The specific IRAs taken into account are part of the method of determining the substantially equal periodic payments which, if modified in a way described in Code section 72(t)(4), will expose the taxpayer to increased taxes. It is noted that if two or more IRAs are used in determining the substantially equal periodic payments, the distributions need not be made from all of the pertinent IRAs. The distributions may be made solely from one of the IRAs, or from a combination of the IRAs.

Under the methodology proposed by Taxpayer A, only the newly established IRA (IRA Y) will be used to determine the substantially equal payments. Based on Taxpayer A's date of birth

*** he attained 55 years of age on

*** The life expectancy for Taxpayer A from Table V is 28.6 years. The whole number portion of this life expectancy is 28 years. Using an account balance of \$6,297,216 for the newly established IRA, and a rate of interest of 7.59 percent, the annual beginning of year payment is \$510,000.

Accordingly, we have determined that annual distributions from IRA Y in the amount of \$510,000 would be part of a series of substantially equal periodic payments within the meaning of Code section 72(t)(2)(A)(iv). Provided that the requirements of section 72(t)(4) are satisfied, such payments will not be subject to the additional tax imposed under Code section 72(t)(1).

Taxpayer A will turn age 59-1/2 on

*** Therefore, if Taxpayer A receives at least five annual payments of \$510,000 from IRA Y (at least one during each of the years 1997, 1998, 1999, 2000, and 2001), and does not otherwise modify his IRA Y distribution scheme (i.e. make additional withdrawals from the IRA, etc.) until at least after

*** the requirements of Code section 72(t)(4) with respect to IRA Y and the payments made will be satisfied.

Therefore, based on the above, with respect to the second and third ruling requests, we conclude:

(2) That the proposed method of determining periodic payments from Taxpayer A's IRA Y results in substantially equal periodic payments within the meaning of Code section 72(t)(2)(A)(iv) and that, accordingly, such payments will not be subject to the additional tax imposed by Code section 72(t)(1) unless the requirements of Code section 72(t)(4) are not met; and

(3) that the requirements of Code section 72(t)(4) will be met if Taxpayer A begins to receive \$510,000 annually from IRA Y during 1997 (the year IRA Y is established), and continues to receive \$510,000 annually from IRA Y each year until at least the year 2001.

This ruling letter is based on the assertions of Taxpayer A's representative that Taxpayer A's 1997 Plan X distribution will not constitute one in a series of substantially equal payments made over a period referenced in Code section 402(c)(4). Furthermore, it assumes that Plan X either is or will be qualified under Code section 401(a) at all times relevant thereto, and that its trust will be tax-exempt under Code section 501(a) at all times relevant thereto. Finally, it assumes that IRA Y which Taxpayer A proposes to set up to receive his Plan X distribution will meet the requirements of Code section 408(a).

Pursuant to a power of attorney on file in this office, a copy of this letter ruling is being sent to your authorized representative.

Sincerely yours,

Frances V. Sloan
Chief Employee Plans
Technical Branch 3

Enclosures:

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Form 437