

Notice 89-25, 1989-1 CB 662, Question and Answer 12

Reference(s): Code Sec. 72

Q-12: In the case of an IRA or individual account plan, what constitutes a series of substantially equal periodic payments for purposes of section 72(t)(2)(A)(iv)?

A-12: Section 72(t)(1) imposes an additional tax of 10 percent on the portion of early distributions from qualified retirement plans (including IRAs) includible in gross income. However, section 72(t)(2)(A)(iv) provides that this tax 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 the employee and beneficiary. Section 72(t)(4) provides that, if the series of periodic payments is subsequently modified within five years of the date of the first payment, or, if later, age 59 1/2, the exception to the 10 percent tax under section 72(t)(2)(A)(iv) does not apply, and the taxpayer's tax for the year of modification shall be increased by an amount, determined under regulations, which (but for the 72(t)(2)(A)(iv) exception) would have been imposed, plus interest.

Payments will be considered to be substantially equal periodic payments within the meaning of section 72(t)(2)(A)(iv) if they are made according to one of the methods set forth below.

Payments shall be treated as satisfying section 72(t)(2)(A)(iv) if the annual payment is determined using a method that would be acceptable for purposes of calculating the minimum distribution required under section 401(a)(9). For this purpose, the payment may be determined based on the life expectancy of the employee or the joint life and last survivor expectancy of the employee and beneficiary.

Payments will also be treated as substantially equal periodic payments within the meaning of section 72(t)(2)(A)(iv) if the amount to be distributed annually is determined 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 (with life expectancies determined in accordance with proposed section 1.401(a)(9)-1 of the regulations) at an interest rate that does not exceed a reasonable interest rate on the date payments commence. For example, a 50 year old individual with a life expectancy of 33.1, having an account balance of \$100,000, and assuming an interest rate of 8 percent, could satisfy section 72(t)(2)(A)(iv) by distributing \$8,679 annually, derived by amortizing \$100,000 over 33.1 years at 8 percent interest.

Finally, payments will be treated as substantially equal periodic payments if the amount to be distributed annually is determined by dividing the taxpayer's 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. If substantially equal monthly payments are being determined, the taxpayer's account balance would be divided by an annuity factor equal to the present value of an annuity of \$1 per month beginning at the taxpayer's age attained in the first distribution year and continuing for the life of the taxpayer. For example, if the annuity factor for a \$1 per year annuity for an individual who is 50 years old is 11.109 (assuming an interest rate of 8 percent and using the UP-1984 Mortality Table), an individual with a \$100,000 account balance would receive an annual distribution of \$9,002 ($\$100,000/11.109 = \$9,002$).