How are substantially equal periodic payments from an IRA calculated for purposes of IRC Section 72(t)?

The 10 percent early (premature) distribution tax does not apply to distributions that are part of a series of substantially equal periodic payments made at least annually for the life or life expectancy of the individual or the joint lives or joint life expectancy of the individual and his or her designated beneficiary.[[1]](#footnote-1)

The IRS has approved three methods, explained below, under which payments will be considered to be “substantially equal periodic payments.”[[2]](#footnote-2) Regardless of which method is used, the series of payments must continue for the longer of five years or until the individual reaches age 59½. Ordinarily, a “modification” (see below) that occurs before this duration requirement is met will result in the penalty and interest being imposed on the entire series of payments, in the year the modification occurs.[[3]](#footnote-3) A “one time election” (see below) to change methods is permitted if certain requirements are met.[[4]](#footnote-4) A change in the payment series as a result of disability or death also does not trigger the penalty.[[5]](#footnote-5)

The three approved methods are as follows:

The required minimum distribution (“RMD”) method requires use of a calculation that would be acceptable for purposes of calculating the required minimum distributions under IRC Section 401(a)(9). Consequently, the account balance, the life expectancy, and the resulting annual payments are redetermined each year. Such annual fluctuations will not be considered modifications.[[6]](#footnote-6) Under this method, the same life expectancy table used for the first distribution year must be used for each following year.[[7]](#footnote-7) Although the Worker, Retiree and Employer Recovery Act of 2008 (“WRERA 2008”) waived RMDs for 2009, this does not apply for purposes of the substantially equal periodic payment exception to the early distribution penalty.[[8]](#footnote-8)

How are substantially equal periodic payments from an IRA calculated for purposes of IRC Section 72(t)?

The fixed amortization method, under which the annual payment is determined by amortizing the individual’s account balance in level amounts over a specified number of years determined using the chosen life expectancy and interest rate as explained below.[[9]](#footnote-9) The account balance, life expectancy, and resulting annual payment are determined once for the first distribution year, and the annual payment is the same amount in each year thereafter.[[10]](#footnote-10) The ability to recalculate the amount of the payment each year by using the taxpayer’s life expectancy with the amortization method was approved in a letter ruling.[[11]](#footnote-11)

The fixed annuitization method, under which the annual payment is determined by dividing the individual’s account balance by an annuity factor that is the present value of an annuity of $1 per year beginning at the individual’s age attained in the first distribution year and continuing for the life of the individual (or the joint lives of the individual and a beneficiary). The annuity factor is derived using the mortality table provided in a 2002 IRS guidance and an interest rate chosen as explained below. The account balance, annuity factor, interest rate, and resulting annual payment all are determined once for the first distribution year and the annual payment is the same amount each year thereafter.[[12]](#footnote-12) The ability to recalculate the amount of the payment each year by using the taxpayer’s life expectancy with the annuitization method was approved in a letter ruling.[[13]](#footnote-13)

There are three life expectancy table options in the 2002 guidance, all taken from the 2002 RMD regulations:[[14]](#footnote-14) the single life expectancy table, the joint and last survivor life expectancy table, and the uniform lifetime table. (Because the uniform lifetime table in the RMD regulations begins at age 70, the IRS included an expanded version covering a broader range of ages).[[15]](#footnote-15)

An interest rate must be used that does not exceed 120 percent of the federal mid-term rate (determined in accordance with IRC Section 1274(d)) for either of the two months immediately preceding the month in which the distribution begins.[[16]](#footnote-16)

How are substantially equal periodic payments from an IRA calculated for purposes of IRC Section 72(t)?

The IRS has stated that individual retirement plans did not have to be aggregated for purposes of calculating a series of substantially equal periodic payments.[[17]](#footnote-17) If a taxpayer owns more than one IRA, any combination of the IRAs may be taken into account in determining the distributions by aggregating the account balances of those IRAs. But a portion of one or more of the IRAs may not be excluded to limit the periodic payment to a predetermined amount.[[18]](#footnote-18)

**Planning Point: The ability to split up or aggregate IRAs in advance of a payout makes the calculation extremely flexible. Furthermore, creating separate accounts is a good way to avoid tying up any more IRA funds than is absolutely necessary to support the needed payout.**

If an individual with more than one IRA chooses to base a series of substantially equal periodic payments on the total of all of his or her IRAs, the annual distribution may be received from any or all of the accounts.[[19]](#footnote-19)

**Planning Point: It generally is useful to select the substantially equal periodic payment method that comes closest to withdrawing the amount that is desired. Under the amortization or annuitization methods, higher interest rates result in higher payments; lower interest rates result in lower payments. In general, having a designated beneficiary can reduce the amount of the payments (calculations can be based on two lives rather than one); a younger beneficiary results in lower payments, an older beneficiary results in higher payments. Selecting IRA accounts with a lower aggregate account balance results in lower payments; selecting IRA accounts with a higher aggregate account balance results in higher payments.**

1. IRC Sec. 72(t)(2)(A)(iv). [↑](#footnote-ref-1)
2. Rev. Rul. 2002-62, 2002-2 CB 710, modifying Notice 89-25, 1989-1 CB 662, A-12. [↑](#footnote-ref-2)
3. IRC Sec. 72(t)(4). [↑](#footnote-ref-3)
4. Rev. Rul. 2002-62, 2002-2 CB 710. [↑](#footnote-ref-4)
5. IRC Sec. 72(t)(4). [↑](#footnote-ref-5)
6. Rev. Rul. 2002-62, 2002-2 CB 710, Sec. 2.01(a). [↑](#footnote-ref-6)
7. Rev. Rul. 2002-62, 2002-4 CB 710, Sec. 2.02(a). [↑](#footnote-ref-7)
8. Notice 2009-82, 2009-2 CB 491. [↑](#footnote-ref-8)
9. Rev. Rul. 2002-62, 2002-2 CB 710, Sec. 2.01(b). [↑](#footnote-ref-9)
10. Rev. Rul. 2002-62, 2002-2 CB 710, Sec. 2.01(b). [↑](#footnote-ref-10)
11. Let. Rul. 200432021. [↑](#footnote-ref-11)
12. Rev. Rul. 2002-62, 2002-2 CB 710, Sec. 2.01(c). [↑](#footnote-ref-12)
13. Let. Rul. 200432023. [↑](#footnote-ref-13)
14. See Treas. Reg. §1.401(a)(9)-9. [↑](#footnote-ref-14)
15. Rev. Rul. 2002-62, 2002-2 CB 710, Sec. 2.02(a). [↑](#footnote-ref-15)
16. Rev. Rul. 2002-62, 2002-2 CB 710, Sec. 2.02(c). [↑](#footnote-ref-16)
17. See Let. Ruls. 200309028, 9050030. [↑](#footnote-ref-17)
18. Let. Rul. 9705033. [↑](#footnote-ref-18)
19. See Let. Rul. 9705033. [↑](#footnote-ref-19)