A Practical Guide To

Substantially Equal Periodic Payments

And Internal Revenue Code §72(t)

By

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Fifth Edition

IMPORTANT NOTICE FROM THE AUTHOR

For thirteen years, the implementation of "substantially equal periodic payments", (SEPPs), were governed by the Internal Revenue Code §72(t)(2)(A)(iv), IRS Notice 89-25[1], and a collection of approximately 100 private letter rulings issued to various taxpayers over the period of 1989 through mid-2002. In October, 2002, the Internal Revenue Service issued Revenue Ruling 2002-62[2] which effectively replaced Notice 89-25 commencing January 1, 2003. Jump forward twenty years and we have two new developments: Treasury Decision 9930 focusing on new life expectancy tables which, in general, cause life expectancies to increase by approximately two years; and, the issuance of Notice 2022-6 as a further refinement and in some cases replacement of most portions of Revenue Ruling 2002-62.

There is both good news and bad news here. The good news: the scope of primary authorities on "substantially equal periodic payments" is reasonably limited to five sources: the Internal Revenue Code §72(t)(1) & (2) itself, IRS Notice 89-25, IRS Revenue Ruling 2002-62, IRS Notice 2022-6 and finally a modest collection of federal district court and US Tax court cases. Further, the frequency with which these primary authorities have been issued has been modest generally resulting in a reasonably stable environment. The bad news: when a primary authority has been issued, its effect is usually the meteorologic equivalent of "volcanic". Said another way, any reader and/or student of SEPPs should treat what they might read with near term suspicion for two or more reasons: (1) any source that does not specifically mention that it has incorporated the effect of Notice 2022-6 is definitionally inaccurate and /or wrong; (2) any distribution calculator that similarly does not incorporate Notice 2022-6 should also be treated with suspicion; (3) there are a variety of more detailed SEPP planning issues that had been predominately solved through secondary authorities that now need to be reopened and revisited. As is always the case with a volcano, it takes some time for all of the details to "cool".

As a result of these new rulings as well as subsequent pronouncements, this Guide has undergone a complete re-write during the Winter of 2022 resulting in the issuance of the 5th edition. Without exception, any holder of any previous edition should no longer rely upon it. The author will happily replace any older edition by simply e-mailing a request to themarblegroup@wispertel.net; or if you have acquired a copy of this guide indirectly, please feel free to stop by at www.72tcalc.com for the latest news and an official copy of the 5th edition.

Lastly, recent conversations with the IRS have indicated that they are working on a 72(t) regulation. What the IRS admits to is the creation of an internal work group to write the regulation. What the IRS will not admit to is: timing, scope, content or any specifically targeted areas of perceived errors and/or abuse. Here is what is important: generally, the IRS does not create work groups to write regulations unless it has been externally motivated to do so. Regulations are the top of the IRS document food chain superceding ruling, notices, procedures and even Treasury Decisions. So, if and when the IRS does issue a regulation on 72(t) we will immediately digest it, most likely curse it, let all of you know about it and commence the writing of the 6th edition of this guide.

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1 1989-1 Cumulative Bulletin 662.

2 2002-42, Internal Revenue Bulletin 710, October 21, 2002.

DEFINITIONS

Before starting, just a few definitions seem appropriate as follows:

IRC: the Internal Revenue Code resides in Title 26 of the U.S.C.A. ("United State Code Annotated"), essentially the law of the land on taxation. Modifications to the IRC occur frequently which originate as a bill in the US House of Representatives, is passed by that House, subsequently passed by the US Senate and finally signed by the then President of the United States. The individual sections of a signed bill are then integrated into the IRC creating the IRC of 1986 as amended, usually just shortened to: IRC.

IRA: is an Individual Retirement Account of which there are two basic types: regular IRAs defined within IRC §408(a); and Roth IRAs defined within IRC 408A.

IRS: is the Internal Revenue Service, a department within the U.S. Treasury responsible for administration of the IRC as well as the levying and collection of many types of taxes including all taxes originating from the IRC.

Qualified Plan: is a tax advantaged employer-sponsored plan identified within the IRC. Virtually all qualified plans are found in IRC §§401 through 424. Profit sharing plans (defined by §401(a)), employee contributory plans (defined by §401(k)), and public sector employee plans (defined by §403(b)) are all very common. IRAs, both regular and ROTH **are not qualified plans** although they do have many of the same operational benefits as a qualified plan. Qualified plans are specifically identified in IRC §4874(c).

Retirement Plan: is a general umbrella term used to describe the sum of all qualified plans and all IRAs whenever the distinction between the two is irrelevant. Whenever the distinction between a qualified plan and an IRA is important the term "retirement plan" will not be used.

Deferred Account: is a synonym for retirement plan essentially focused on the biggest tax advantage of all retirement plans; the ability to grow the contents of a retirement plan and "defer" all taxation of the account transactions until such time as withdrawals commence.

IRC §72(t): is an income section of the IRC which imposes regular income tax and surtaxes on withdrawals from all retirement plans. Subsequent sub-sections of IRC §72(t) provide exceptions to the surtaxes. Sometimes these exceptions are for all retirement plans, sometimes for only qualified plans and sometimes only for IRAs.

INTRODUCTION

By the 3rd decade of the twenty-first century, many taxpayers have acquired substantial retirement assets in a variety of tax deferred vehicles, including: qualified plan assets such as §403(b) and §401(k) plans as well as IRAs, both traditional and ROTH.

All distributions from all of the aforementioned accounts are governed by IRC §72(t) which, in addition to regular federal income tax, imposes a 10% surtax on ALL distributions unless one or more of the thirteen exceptions are applicable.

As of March, 2022, IRC §72(t) provides thirteen[3] reasons or exceptions that qualify taxpayers to withdraw monies from their 401(k)s or IRAs (collectively called "deferred accounts"[4]) and avoid the 10% surtax. These exceptions generically fall into two types: transaction or cause specific and process/multi-year. There are eight transaction or cause specific exceptions, all of which will be discussed later in the text. As an example, exception #10 is the ability to withdraw some monies while one is unemployed and has the need to make health insurance premium payments[5]. All eight of these transaction-specific exceptions are either severely limited in scope or are present for coordination purposes. Conversely, the primary focus of this guide is to closely examine the other five "process" or "multi-year" exceptions. They are:

- §72(t)(2)(A)(I) Age 59 ½
- §72(t)(2)(A)(ii) Death
- §72(t)(2)(A)(iii) Disability
- §72(t)(2)(A)(iv) Substantially Equal Periodic Payments (SEPPs)
- §72(t)(2)(A)(v) Separation of Service at Age 55

These five code subsections deal very specifically with how a taxpayer (or his or her estate) may commence withdrawals from their deferred accounts and avoid the application of the 10% surtax on those distributions.

Within this guide, you will find issues and solutions that the general public, professional accountants and tax attorneys seldom confront. Further, due to a general absence of concise and practical information on this subject, many professionals periodically find themselves in a "reinvent the wheel" mode. Unfortunately, every time a wheel is reinvented, it tends to look a little different than the last time --- sometimes a little better and sometimes a little worse. This is a dangerous environment for "re-

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3 Actually there have been several, additional "temporary" reasons that have expired over time which were originally created for hurricane victims as well as COVID related distributions.

4 Within this context, we include all savings plan type accounts of a "defined contribution" nature; e.g. employer contributed assets as well as employee contributed assets that were not taxed at the time of contribution as taxation was deferred under various provisions of IRC §§401-424.

5 IRC §72(t)(2)(D).

invention" in that, as we will discuss in depth later, making a mistake in theory or practice in this area can be extremely costly. Taxpayers are faced with taxation principles and issues that are not easy to understand and at the same time are becoming more popular. Further, implementation of SEPPs, or any of the other exceptions, is almost always a one way transaction; i.e. once a distribution or series of distributions have been made, they are irrevocable and generally can not be replaced, reversed or corrected. As a result, a mistake will, more often than not, invoke IRC §72(t)(4) resulting in the application of the 10% surtax with no methods available to correct the mistake on the part of the taxpayer.

The scope of this text covers a variety of what we collectively call "deferred accounts". This includes all forms of §401(a), §403(b) and §401(k) plans as well as virtually all IRA types, SEPs and SIMPLEs. §401(a) and §403(b) plans can be either defined benefit or defined contribution plans. This text only deals with defined contribution plans and accounts[6]. Frequently, we will use the term "IRA" in an example. The reader should assume that the example applies equally to all types of deferred accounts unless there is a notation to the contrary.

The audience for this text is primarily twofold: individual taxpayers and professionals. More and more individuals are deciding to independently work through the financial issues of early retirement and thus the need to make withdrawals from their deferred accounts before age 59½. Additionally, financial advisors, professional accountants and tax attorneys have no source to go to when a client presents a situation requiring the implementation of §72(t) issues. In both instances, this text should answer almost all of your questions. However, as is needless to say, it is always possible for a client to present a set of facts & circumstances that will cause the answer to become unclear. Whenever this occurs, feel free to drop the author a note at themarblegroup@wispertel.net.

We have attempted to make this text as thorough as possible. Unfortunately, most of the secondary & tertiary authorities written on IRC §72(t) are spread over a variety of document types and locations --- many of which are unfamiliar to the average taxpayer and most practicing professionals. As a result, whenever possible, we have included the literal text, tables and other computations within the text. Finally, we have made every attempt to explain the relevant theory and then bring that theory down to the practical level such that all readers should be comfortable with the basic concepts as well as the computational nuances.

Ninety-nine percent of all published literature on "deferred accounts" is either persuasive in nature ---- meaning that its focus is on why you should have an IRA or why you should contribute to your employer sponsored 401(k) plan; or it is focused on how you should manage these deferred assets during their accumulation years; e.g. should you buy stocks, bonds, mutual funds, etc. To the best of this author's knowledge, there is no other comprehensive literature or writing available on getting your money out; particularly on getting your money out early. That's what this text is all about.

6 Defined benefit plan payments and annuities are ineligible for treatment under IRC §72(t). Instead, these plan types are handled by IRC §72(q)(2) and are outside the scope of this text. However, as a general comment, almost all of the exceptions found in §72(t) are repeated in §72(q) in order to afford the same or similar tax treatment to those taxpayers taking distributions from defined benefit plans.

The author is the first to admit that an in-depth discussion on IRC §72(t) is, on a scale of 1 to 10; a 13 in the dry reading department. As a result, we have occasionally inserted some humor; mostly so everyone can stay awake. On the other hand, humor can be dangerous, as some one can always be offended. No offense, malice or harm in this regard was intended.

SEPP OBJECTIVES

Admittedly most of the following text is tax oriented, more specifically designed to avoid the 10% surtax on early distributions. However, we should back up for a moment and ask: "Why design a SEPP program? What objectives should it meet?". In this regard, the author would like to suggest three, sometimes competing or conflicting objectives:

- Design a SEPP program that meets both current period and future period personal cash flow needs. Meeting cash flow needs implies obtaining some information:
  - What are my current living expenses that I need to replace?
  - What current (or future period) expenses will vanish and what new expenses will appear? In this category there are three expenses that are important to discuss:
    - Most taxpayers commencing SEPPs will realize a 7.65% decrease in expense on their first $147,000[7] of withdrawals or $11,245[8]. This occurs because SEPP distributions are not subject to FICA / Medicare tax whereas virtually all wages and earnings from self-employment are.
    - Medical insurance is a virtual necessity and unfortunately becoming ever more expensive. Some taxpayers will be fortunate & be offered paid or materially subsidized medical insurance coverages to age 65 by their ex-employers as a retiree benefit. Other taxpayers will not be so fortunate and will be forced into the independent insurance market seeking to purchase coverage from retirement age until Medicare takes over at age 65. To put this issue in perspective, let's assume a married 50 year old with a similar aged spouse who might currently have an employer provided medical policy

[7] $147,000 is the FICA wage base for 2022; the last published amount. This limit is inflation indexed such that it will have a tendency to rise between $1000 and $3000 per year going forward.

[8] This savings can grow materially higher for a self-employed taxpayer with $150,000 of income. In this case, the savings would be in the neighborhood of $21,000. Refer to Schedule SE for the specific computations.

that could easily cost $1500 per month. This individual needs to purchase 15 years of medical insurance; but not at $1500 per month. Unfortunately, every year the insurance premium is going to rise between 15% and 25% caused by increased medical provider expenses as well as aging; e.g. a 55 year old uses some materially higher percentage of medical services as does a 50 year old. As a result, the net present value of 15 years of medical coverage can easily approximate $250,000 to $300,000 or more. How does this amount affect your total financial picture? Have you shopped for this insurance and received some quotations?

♦ Money to support others. In this category there are two main groups: parents and the potential for elder care expenses and children (college, disability, home purchase, etc.). And let's not forget the nieces, nephews and the wayward brother-in-law. Further, this area of expense can be a "wild card". Today, a taxpayer may have no expectant needs in this area. However, 36 months from now may look materially different. As a result, throughout this guide, we will repeatedly focus and re-enforce the need to maintain future period flexibility in order to handle those emergencies without undue tax consequences.

In summary, a reasonably concise, multi-year cash flow plan is absolutely critical as one of the prime ingredients to a successful SEPP plan. As we will learn a bit later, SEPPs tend to be pretty much fixed in nature (at least to age 59 ½ or 5 years, whichever occurs later); however, life and its attendant expenses tend to be somewhat more volatile. As a result, it is necessary to build as many of these expense variations into the SEPP plan up-front in order to avoid costly short-falls in later years.

- Design a SEPP program that meets IRS standards. This is what the majority of this text is all about; however, it is often surprisingly the easiest of the three objectives to meet. In other cases, it may become the limiting factor which will require some rethinking of one's cash flow needs.

- Design a SEPP program for life. Or maybe not? There are any number of published "survivability studies" that fundamentally pose one question: "Will my assets survive until after my death or will my assets deplete themselves before my death?[9]". All of these studies disagree when asked the question: "Is a 4.25% withdrawal rate versus 4.75% the safe rate?". All of the studies agree that a safe withdrawal rate is some number that does not exceed 5% for a 50 to 55 year old with a remaining life expectancy in excess of 30 years. Should one then implement a SEPP program at age 50 that is designed to withdraw 8% of the assets for a minimum of the next ten years? Maybe, maybe not. In this regard,

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9 This poses a very serious question of estate planning on the one hand and, on the other hand, perusing the classified's at age 78 for the minimum wage jobs at the fast food restaurant of your choice.

there seems to be two fundamental types of taxpayers facing this question.

- Taxpayer #1 has an IRA which essentially represents all of his or her liquid assets and will therefore be depending on those assets to last a lifetime. This taxpayer should therefore not launch a SEPP program at an 8% withdrawal rate (even though it may be permissible and IRS compliant) as the survivability of the portfolio is somewhere in the 50% to 70% range; e.g. said another way, 1/3rd to ½ of the time, this taxpayer will be living and destitute sometime in his or her later years.

- Taxpayer #2 has a similar IRA and is similarly aged. However, this taxpayer can expect and rely upon receiving a periodic pension commencing at age 60 such that he or she needs to withdraw 8% for the next 10 years at which time the IRA distributions can drop to 3.5% when the pension commences. Similarly, a parent or relative may provide a material inheritance in the not too distant future. As a result, taxpayer #2 is not designing a SEPP program for a lifetime; instead he or she is designing a limited term cash flow plan specifically designed to last 6, 8 or 10 years at the end of which the program will be materially modified and reduced. This taxpayer can afford to design a SEPP program at a 7% or 8% withdrawal rate because of the materially shorter time frame involved.

SEPP objectives are three-fold and are often in conflict with each other with any of the three potentially becoming the limiting or constraining objective. Taxpayers should look long and hard at all three objectives and create a SEPP plan that satisfies all three.

THE FIFTH EDITION

This is the 5th edition of the text. The 1st and 2nd editions were published in 2000 and 2001. The 3rd edition was a complete re-write due to the issuance of Revenue Ruling 2002-62. The 4th edition was published in late 2004 (and updated in 2006) reflecting an increased knowledge base pertaining to the interpretation of Revenue Ruling 2002-62.

This 5th edition actually has a decreased scope when compared to the 4th edition. We did so in order place the majority of our focus on changes caused by TD 9930 and Notice 2022-6. As a result, anyone in possession of a 1st through 4th edition copy should destroy it as many of the tactical implementation rules identified in these earlier editions have now been overruled.

DISCLAIMER

In a way, it is unfortunate that books of this nature require disclaimers, but such is today's legal environment. We have made every effort to be accurate and believe that to be the case as of March, 2022. Unfortunately, the IRC and related documents of authority are ever-changing. As a result, in some small fashion, this text has a high probability of becoming out-of-date within several months to a year. As a result, we can offer no prospective promises regarding accuracy beyond the date of publication. Further, purchase or other acquisition of a copy of this text does not create any type of client-professional relationship upon which a client may typically rely. Recognizing that this does not really help the reader, we suggest that serious readers intent on implementing one or more of the strategies outlined in this text should confirm to themselves that they are in fact dealing with the most current set of facts and applicable law. The easiest way to do this is to hire a tax CPA or tax attorney who is an expert[10] on these topics.

Lastly, just a couple of points about footnotes. Generally, the reader will find two types of footnotes throughout the text: one, specific citations to pertinent sections of the Internal Revenue Code, and two, more explanatory comments and / or author opinion on the subject matter at hand. If you are a tax accountant or lawyer, you will want to read all of the footnotes, particularly the first group, as they will provide you with a quick guide to get directly to the source authorities such that you can form your own opinions and interpretations. General interest readers can probably skip the citation footnotes (why would you care) and focus more on the explanatory and opinion oriented footnotes.

FORMAT

We have intentionally published this guide in 8 ½" x 11" format for several reasons. First, because it was a lot easier and less expensive for the author to publish in this format. Secondly, if we reduced the size to the more typical 6" x 9" format, the length of text doubles or triples and then everyone would have difficulty reproducing critical sections for their use. Lastly, we like the idea of a loose-leaf, ring-bound document from a reader's perspective; it automatically provides room for note taking and question asking. Implicitly, the reader's notes, on the flip side, should start with: "Does this mean I can do......?" If you do not find the answer to your question within a couple of pages, please call or write to the author.

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[10] Would you hire a podiatrist to perform brain surgery? We think not. Similarly, fewer than 1% of all tax attorneys and accountants are going to be conversant, much less expert, on SEPPs. When seeking out professional help remember that, because you have read this guide, 90% of time you know more than the expert you might be hiring. Also, please the "tech corner" at www.72tcalc.com; third article on "Should You Hire A Professional..."

BIOGRAPHICAL INFORMATION

William J. Stecker, (Bill), earned his bachelor's degree in Finance & Applied Mathematics. He also holds a Masters of Science in Accounting (with distinction) from DePaul University (Chicago, Illinois) earned in 1983. He is a Certified Public Accountant[11] since 1980 and a member of the American Institute of Certified Public Accountants as well as a member of the Illinois and Colorado state societies.

Bill has spent over four decades in accounting, finance and tax related fields. Further, he has particular in-depth knowledge on Internal Revenue Code §72(t), having made multiple and successful private letter ruling requests and determination letter requests to the Tax Exempt & Governmental Entities Division of the Internal Revenue Service.

He has also published on §72(t) issues several times including:

(1) A Practical Guide To Substantially Equal Periodic Payments And Internal Revenue Code §72(t). This guide is now in its 5th edition and available for free on this website.

(2) Excerpts of the above have periodically appeared in: Journal of Retirement Planning (A Commerce Clearing House publication) and the Journal of Taxation (A Thompson Reuters publication).

(3) The issuance of more than ½ dozen favorable private letter rulings. These rulings are published by the IRS six months after issuance; admittedly in redacted and abbreviated form.

Bill owns The Marble Group, Ltd. (an Illinois corporation), an accounting, tax representation and financial consulting group based in Illinois. Bill devotes most of his time to tax issues, specializing in retirement plan and participant issues --- primarily §72 and §§401-424 of the IRC. He is available for individual client representations and can be reached at: The Marble Group, Ltd., 332 South Michigan Avenue , Suite 1032 #M29, Chicago, Illinois 60604 or themarblegroup@wispertel.net or call (312) 361-0221.

Bill now splits his time between Chicago and Colorado as he is just plain old sick and tired of Chicago weather; particularly the Winters and freezing rain coming from Lake Michigan. Lastly, Bill maintains an active federal income tax practice as well as SEPP plan design consulting and opinion practice across all fifty states.

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11 Licensed in Illinois. William also holds a Preparer Tax Identification Number, ("PTIN") and an IRS Centralized Authorization File Number, ('CAF") with the IRS.

CHAPTER 1 --- CURRENT LAW

In this chapter we present the currently available resources and authorities that offer guidance on how to make IRA withdrawals that are not subject to the 10% surtax or penalties. When aggregated together, these sources create something of a rule book. To help clarify the technical passages, we have added a brief explanation of each citation. Further, this chapter will discuss all 13 exceptions to the surtax and conclude with an introduction to substantially equal periodic payments, SEPPs, exception #4.

THE INTERNAL REVENUE CODE

We necessarily start with the Internal Revenue Code itself which imposes a 10% surtax on all distributions[12] from deferred accounts:

> *IRC §72(t)(1) IMPOSITION OF ADDITIONAL TAX.--If any taxpayer receives any amount from a qualified retirement plan (as defined in §4974(C)), the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.*

There are several important points in this passage. First, is that the 10% surtax is always imposed on any and all retirement plan distributions. Second, the 10% surtax is only imposed on amounts that are includible in the taxpayer's gross income; therefore distributions that are not includible in gross income are neither taxed nor surtaxed[13]. Fortunately, immediately following IRC §72(t)(1), IRC §72(t)(2) launches into a variety of exceptions to the general rule. It is important to remember that this is one of those code sections that was intentionally drafted in reverse; e.g. the 10% surtax always applies unless the taxpayer fully meets one or more of the exceptions identified in §72(t)(2). As a result, if the taxpayer does not fully satisfy an exception, then the 10% surtax is applied by the IRS without any need for further statutory action.

There is an important distinction here. IRC §72 says that all distributions from retirement accounts are includible gross income (except for distributions of basis). Therefore, a retirement distribution gets taxed just like all other types of ordinary income using the graduated income tax percentages with varying dollar brackets based on filing status: single, married filing jointly, married filing

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12 IRC §72(t)(1).

13 We are nearing almost 50 years of retirement plans. Throughout these years there have been, and continue to be, certain circumstances where taxpayers could add "after-tax" contributions to their retirement accounts. These "after tax" contributions create "basis" in the account. When "basis" dollars are withdrawn from the account, those dollars are not taxed as they have been previously taxed when originally contributed to the account. Make sure to check your account statements to absolutely know what your basis is by account.

separately and head of household. Therefore a taxpayer's tax on their retirement distributions can be as low as zero and as high as approximately 40%, all based on the taxpayer's overall gross income & tax deduction picture. Then IRC §72(t)(1) goes on to effectively say: we don't care what your regular income tax picture looks like. For retirement plan distributions only we are going to apply an additional 10% tax (called a surtax because it is on top of or additional to) based on the amount distributed. So even if the taxpayer's regular tax is zero, the 10% will still apply solely because it is a retirement plan distribution. Finally, IRC §72(t)(2) comes along as says that the 10% surtax will either be waived immediately or deferred (to eventually be waived) as long as the taxpayer follows the detailed exception rules following.

EXCEPTION #1 AGE 59 ½[14]

The best known exception is achieved by attaining age 59 ½[15]. This exception would appear, on its face, to be rather easy to apply, e.g. make a withdrawal after you are 59 ½ and you will not be subject to the 10% surtax. However, there are three very specific rules which apply:

- The IRS is required to make a literal age interpretation here because it is the IRC which specifically says, "made on a day on or after the date on which the employee attains the age of 59 ½." So when do you have your 59th and ½ birthday? Exactly 183 days after your 59th birthday. As an example, if your birthday is April 26, 1956, your 59 ½ birthday is October 26, 2015. A withdrawal made on this date or later will be fine; a withdrawal made on October 25th or earlier will cause the 10% surtax to apply[16].

- As we will learn later, if you have commenced substantially equal periodic payment distributions subject to IRC §72(t)(2)(A)(iv), the use of exception #1 may be held in abeyance for some amount of time until all of the requirements of exception #4 are fully satisfied[17].

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14 IRC §72(t)(2)(A)(i).

15 Who chose age 59 ½? Congress. Why did they chose 59 ½? Short answer — no one knows. Long answer — still no one knows. Suspicion — in 1976 some Congressperson believed that our mathematical skills were materially declining and insisted on 59 ½ as age 60 would be too easy for the mathematically challenged.

16 Several other sections of the IRC and this text will employ the concept of a taxpayer's "highest attained age" within a particular calendar / tax year. This is not one of those situations. Instead, the IRS is required to and does measure to the day.

17 By way of example, assume a taxpayer, aged 57, commenced a SEPP plan and then materially altered the annual distributions at age 60. The distributions made from age 57 to age 59 ½ would be retroactively surtaxed at 10% plus interest because the taxpayer would not have satisfied the "5 year" rule. The distributions made on or after age 59 ½ would not be surtaxed as IRC §72(t)(2)(A)(i) would independently apply, irrespective of the failure within §72(t)(2)(A)(iv).

- All IRAs of all types (as well as all other deferred accounts) are always individually owned. As a result, if two individuals are married and only one is over the age of 59 ½; then, only that individual who is age 59 ½ or older is eligible for this exception.

EXCEPTION #2 DEATH[18]

Death, although never really a desirable outcome, is usually a fairly straight-forward event; some one either is or is not deceased & just about every jurisdiction on the planet has a coroner (or equivalent) who is required to issue a death certificate when this unfortunate event occurs. Thus, the test is simple: presence of a signed death certificate (irrespective of cause) passes; anything else does not.

EXCEPTION #3 DISABILITY[19]

The full text of exception #3 says, "attributable to the employee's being disabled within the meaning of subsection (m)(7)." "Attributable" means that in order to use this exception, you, personally, must be physically and/or mentally disabled according to the following definition:

> *"...an individual shall be considered to disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued or indefinite duration. An individual shall not be considered to be disabled unless he furnishes proof of the existence thereof in such form and manner as the Secretary may require."*
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> *IRC §72(m)(7)*

What does the preceding mean? First, with certainty, if you choose to use this exception and are subsequently audited, you will be required to present external proof and evidence that you are disabled. Second, the IRS has issued a fairly in-depth regulation on this subject. It says in part:

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18 IRC §72(t)(2)(A)(ii).

19 IRC §72(t)(2)(A)(iii).

> *"In determining whether an individual's impairment makes him unable to engage in* ***any substantial gainful activity*** *[emphasis added], primary consideration shall be given to the nature and severity of his impairment. Consideration shall also be given to other factors such as the individual's education, training, and work experience. The substantial gainful activity to which section (m)(7) refers is the activity, or comparable activity, in which the individual customarily engaged prior to the arising of the disability..."*
>
> *IRC Reg. §1.72-17A(f)*

The above Code and regulation language imply several tests or hurdles that must both be met or exceeded in order to qualify for this exception. They are:

- Effectively, the **disability must be total** as opposed to partial. As an example, some one may be disabled in all outward appearances; however, if that person were capable of (irrespective of whether he does or not) returning to work on a part-time basis performing his or her pre-disability job function; then that person would not be considered disabled under this definition.

- The disability is always measured in context to the individual's pre-disability occupation. As an example, two brothers are in a vehicular accident resulting in both brothers becoming paraplegic & both brothers fully recover but for the use of their legs. One brother was a professional football player & the other was a surgeon. The former is disabled, the later is not. At one time, cancer was considered, almost automatically, to be a total and permanent disability. With the advent of new drugs & surgical procedures this is no longer the case. As a result, at least over some moderate to lengthy period of time, the concept of "disability" becomes somewhat of a moving target.

The IRS will consider any and all external evidence the taxpayer produces but is not necessarily bound or obligated to honor that evidence in making its determination. Such evidence usually will include physician statements, employer statements, proof that you are already collecting private disability insurance, and Social Security disability proceeds --- Social Security being the most persuasive evidence. Further, being disabled has been classified as a "facts and circumstances" test by the IRS, accordingly, they will not rule in advance on this issue for individual taxpayers, nor is there any list existing that automatically creates disabled status. As a result, this author believes that using this exception is a fairly dangerous strategy unless the disability is beyond a shadow of a doubt. With any lesser disability, a taxpayer is well advised to seek the professional opinion of an attorney who specializes in disability matters.

EXCEPTION #5 SEPARATION OF SERVICE AT AGE 55[20]

Wait a minute. What happened to exception #4? Number 4 --- substantially equal periodic payments --- is by far, the most difficult of the process / multi-year exceptions to understand and is the most difficult of all of the exceptions to implement correctly. As a result, we are going to skip #4 for the moment and finish the discussion of the remaining exceptions first.

In most cases in this text, we treat "deferred plan assets" and IRAs as being the same thing and accordingly receive the same treatment as well as use of the exceptions under IRC §72(t). However, this exception #5 is one of the exceptions to the general rule. Exception #5 provides an ability for a separated employee to commence withdrawals provided he is 55 or older when separated from the employer who is the plan sponsor from which the now separated employee wishes to make withdrawals. Unfortunately, IRC §72(t)(3)(A) says in part that §72(t)(2)(A)(v) "does not apply to distributions from an individual retirement plan."[21] This simple sentence effectively forces a split between qualified plan assets and IRA assets and makes subsection (v) only available to the former and disallows the same treatment for IRA assets. Notice 87-13 provides a further amplification of how to interpret IRC §72(t)(2)(A)(v) by saying:

> *"Section 72(t) (as added by TRA '86) applies an additional tax equal to 10 percent of the portion of any "early distribution" from a qualified plan...that is includible in the taxpayer's gross income...A distribution to an employee from a qualified plan will be treated as within §72(t)(2)(A)(v) if (I) it is made after the employee has separated from service for the employer maintaining the plan and (ii) such separation from service occurred during or after the calendar year in which the employee attained age 55."*
>
> *IRC Notice 87-13*

Finally some reasonably clear language. As we will learn later, SEPPs are by their nature very restrictive. Here, we can skip all of the SEPP rules if the taxpayer can comply with the rules enumerated in Notice 87-13. What are those rules?

- The taxpayer must terminate from his or her employer in the same tax year as he or she attains the age of 55 or older. This is not the same as being 55 or older when you quit. Instead, one need only reach age 55 anytime in the same calendar year, even if attaining age 55 occurs six months; or 364 days after termination.

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20 IRC §72(t)(2)(A)(v). Recently added IRC §72(t)(10) has now effectively amended IRC §72(t)(2(A)(v) to read "age 50" whenever the distribution being made is to a "qualified public safety employee from a governmental plan".

21 Why this distinction between plan assets and IRA assets (definitionally not a qualified plan) remains a mystery.

- The assets withdrawn must be withdrawn directly from the plan sponsored by the employer from which the employee has just terminated. **This is critical.** Further, there are three subsidiary issues of equal importance:

  - If the taxpayer terminates employment with the employer / plan sponsor and immediately rolls the plan assets into a rollover IRA; the IRA assets, though they did originate from the qualified plan, are now ineligible for treatment under §72(t)(2)(A)(v). The assets must absolutely remain in the plan.

  - Working for a single employer for thirty or more years is pretty much an event of the past. As a result, it is not uncommon for a taxpayer to have two, three or more §401(k) plans and/or related conduit IRA accounts[22]. Nonetheless, Notice 87-13 tells us that we can only make withdrawals from the plan account from the employer from which the employee just separated. How do we get at the plan assets from prior employers? The easiest solution is to perform a series of rollovers by rolling the assets forward from either prior employer plans or conduit IRAs into your current employer's plan. Further, these rollovers invariably need to be performed before you terminate, as rollovers are often prohibited for terminated plan participants. On its face, this all appears to be illogical. How can it make any difference if all of the money is in the current plan versus spread out over three or four plans from different employers? We all know it doesn't make a real difference; however, this is one of those situations where form does govern over substance.

- The third requirement to implement this exception is not IRS related; rather, one needs a cooperative plan administrator. The essence of exception #5 is to be able to make periodic distributions of differing amounts whenever you want & not pay the 10% surtax. This necessarily means that your current plan & plan administrator must support periodic distributions --- not all plans allow this.

In summary, taxpayers who are 55 (or will be 55 in the current tax year) and are separating from their employer[23] should pause and think very carefully about this issue. There is no clear-cut obvious or winning decision here as there are pros and cons to each decision path. The biggest advantage is that the taxpayer need not pay any attention to SEPPs and their rules and instead can withdraw any amount at any time. The biggest disadvantage is that most §401(k) plans limit investment choices (often to mutual funds

[22] We use the term "conduit IRA" account here to mean a temporary IRA account housing the assets of a prior employer's qualified plan, usually waiting to become eligible to be rolled into a new employer's qualified plan.

[23] In today's economic environment, many taxpayers are being offered "early retirement" packages from their employers. Often, an employer will be willing to structure severance pay for an early retiree such that the periodic severance pay, and therefore employment period, extends into the first few weeks of January of the next tax year in which the employee will attain age 55 thus making this exception a viable planning alternative.

only) which may not be to one's liking. As a result, any taxpayer in the 54 ½ to 59 ½ age window leaving their employer should seek professional help before automatically rolling over §401(k) assets into an IRA.

EXCEPTIONS #6 THROUGH #14

These exceptions are the transaction specific exceptions in that they define specific situations where distributions are not surtaxed and tend to be fairly limited in scope and / or dollar amount.

- **#6 §404(k) Stock Dividends[24].** This will likely occur whenever you are a member of an older §401(a) plan in which the plan sponsor / employer contributes employer stock to the plan. Further, the original plan was drafted in a manner that requires that when the corporation declares a dividend, that dividend must be paid on the securities held in the plan. Strangely enough, the actual dividend dollars cannot be paid into the plan itself but must instead be paid directly to the plan participants. In short, almost all readers need not concern themselves about this exception. If you are subject to it, your plan administrator will let you know how to declare the dividends received as income and specifically how to avoid the 10% surtax.

- **#7 Tax Levies[25].** Should you be unfortunate enough to be subjected to a federal tax levy[26], Congress has graciously determined that the 10% surtax will not be due. However, there are several catches: one, regular federal income tax will still be due upon the distribution of the IRA; two, the distribution of the IRA must be pursuant to a court ordered levy and the actual distribution from the IRA must be made directly to the IRS. Conversely, if the IRS sends you a deficiency notice or otherwise obtains a judgement against you and you voluntarily cash in the IRA to pay the deficiency or judgement, this exception will not apply.

- **#8 Medical Expenses[27].** You may make distributions from your IRA up to the amount of your qualifying medical expenses[28] and escape the payment of the 10% surtax remembering that regular federal income taxes will still be due. A little higher math is involved in that you may only withdraw monies from the IRA penalty-free to the extent that your qualifying

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24 IRC §72(t)(2)(A)(vi).

25 IRC §72(t)(2)(A)(vii).

26 This is tantamount to the IRS performing asset seizure, where they will typically take your residence, your cars, your jewelry, and, by the way, your IRAs as well, all pursuant to a court order.

27 IRC §72(t)(2)(B).

28 See IRC §213; typically the same medical expenses you would place on Schedule A --- Itemized Deductions.

medical expenses exceed 7 ½ % of your adjusted gross income. Further, a distribution to cover these medical expenses[29] also increases your AGI. Assume your AGI before the distribution is $100,000; you have $22,500 of medical expense of which $15,000 is eligible remembering that the first 7½% or $7,500 is ineligible. You might withdraw $15,000 from your IRA thinking it will all escape the 10% penalty. Unfortunately, the $15,000 is added to your AGI resulting in $8,625 of ineligible medical expense. Thus, $13,875 is protected and $1,125 is not resulting in a "hidden" 10% penalty of $112.50.

- **#9 Qualified Domestic Relations Orders[30]**, (QDROs). Only slightly more fun than a tax levy, a QDRO is a court order signed by a judge, typically as a result of a divorce proceeding. With respect to your IRA, the judge can conceivably sign two different types of QDROs:

  - The judge may sign an order requiring the division of your IRA into two separate IRAs; typically one for you and the another for your ex-spouse. In this instance, an asset is being divided up where the essential character of the two new IRAs remains unchanged; just the names on the accounts have been altered. This "divide the asset" style QDRO is a non-taxable event as governed by IRC §414(p).

  - The judge may also sign an order requiring a periodic payment stream from your qualified plan[31] thus creating a taxable event to one or more of the ordered payees ---- typically to the ex-spouse or children. In this case a taxable event has occurred requiring that income tax be paid on the amounts distributed each year. Fortunately, the 10% surtax is excused regardless of your age.

- **#10 Payment of Health Insurance Premiums While Unemployed[32].** If you have been or were unemployed for twelve or more weeks, you may make withdrawals from your IRA up to the amount of your health insurance premiums for the period during which you were unemployed.

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29 Further, the U.S. Tax Court has just recently ruled that the distribution from the IRA and the payment of the medical expenses must occur within the same tax year. See Jeanette Kimball v. Commissioner; T.C. Summ. Opinion 2004-2 #16640-02S.

30 IRC §72(t)(2)(C).

31 Please note the change in language here to "qualified plan". IRAs are not eligible for this exception.

32 IRC §72(t)(2)(D).

- **#11 Higher Education[33].** Generally speaking, distributions from your IRA[34] can be made to pay for post-secondary "qualifying" educational expenses for yourself, your spouse and your children. Qualifying expenses[35] include: tuition, fees, books, supplies & equipment required for attendance at an eligible educational institution. Further, room & board become qualifying expenses when the student is at least a ½ time student. These permissible withdrawals are reduced by any Hope scholarship credits or Lifetime learning credits that are in effect.

- **#12 First Time Home Purchase[36].** You may withdraw up to $10,000, per lifetime, from your IRA[37] to purchase a principal residence --- provided that you have not owned a home in the last 24 months. The specific rules are fairly sticky here; as a result, the author suggests you seek professional assistance to insure that you correctly qualify when attempting to use this exception.

- **#13 Qualified Military Reservists Called To Active Duty.** Reservists called to active duty for 179 days or more may make unlimited distributions from their deferred assets provided that the actual distribution occurs during the active duty period.

- **#14 Distributions From Retirement Plans In Case OF Birth Of Child Or Adoption.** Parents may withdraw up to $5,000 each for the birth of a child or adoption during a one year period commencing on the date of birth or adoption. Further, this exception can be repeatedly used for subsequent births and adoptions.

A word of caution is appropriate here. Exceptions #6 through #14 all vary in complexity, each with its own set of detailed qualifying rules. The proceeding has been a brief overview simply to let the readers know that the exceptions exist and may be used when the proper conditions present themselves. Exceptions can generally be used independent of one another; however, there is usually one right way and several wrong ways to implement any of the exceptions. Although some of the exceptions appear to be fairly generous, particularly for circumstantial distress, it is advisable to seek professional assistance when attempting to implement any of these exceptions. An exception, incorrectly implemented will cause the 10% surtax to be imposed and there is generally no facility to correct mistakes once they have occurred.

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33 IRC §72(t)(2)(E).

34 In another strange twist, this exception is only available to IRAs and unavailable to other qualified plan assets.

35 IRC §529(e)(3).

36 IRC §72(t)(2)(F).

37 Same as footnote 35.

EXCEPTION #4 SUBSTANTIALLY EQUAL PERIODIC PAYMENTS

IRC §72(t)(2)(A)(iv) introduces us to a lesser known and the least understood exception --- the concept of a "substantially equal periodic payment" (SEPP)[38]. Understanding a SEPP necessarily starts with the IRC itself:

> *"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 designated beneficiary."*
>
> *IRC §72(t)(2)(A)(iv)*

We can learn a lot about SEPPs from just this one sentence. It is actually easier to take the term "substantially equal periodic payments" and deal with each word in reverse order:

- PAYMENTS in this case means a dollar [39] withdrawal from the deferred account. Further, because of the plural, we can infer that there will need to be more than one payment.

- PERIODIC implies that each of the multiple payments will occur over some set of defined intervals. Immediately following, we find the language: "not less frequently than annually." As a result, we know the outside limit with certainty --- a minimum of once a year. However, there is no guidance about more frequently than annually. As we will learn later, monthly and quarterly distributions are just fine as well.

- EQUAL implies that the withdrawals from the deferred account will be of equal or the same dollar amount.

- SUBSTANTIALLY is potentially the most interesting word in the sentence. It becomes a modifier to the word "equal". If Congress had intended for the payments to be literally equal, it would not have used the adjective "substantially". As a result, we now have "sort of" or "almost" equal payments because we do not yet know how to interpret the word "substantially"; e.g. where is the dividing line between substantially equal and unequal?

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38 Conversationally, many people may say, "I have a SEPP-IRA, or I have a 72T plan or a 72T-IRA, or I am taking 72T or SEPP distributions from my IRA. Invariably, these are all short-hand expressions for distributions made pursuant to IRC §72(t)(2)(A)(iv).

39 99% of all readers will be contemplating making cash distributions from their IRAs. "In kind" distributions are also permitted; however, when this occurs, the asset distributed "in kind" must be valued at fair market value at the time of distribution. Needless-to-say, the IRS tends to look closer at "in kind" distributions.

- MADE FOR THE LIFE effectively creates a multi-year time span that is defined as either the life expectancy of the employee[40] or the dual expectancies of the employee and his beneficiary. We don't know what this number is yet. But we should expect it to be a large number.

Next, we need to turn out attention to IRC §72(t)(4)(A) which provides some additional rules:

> *"[If]...the series of payments under such paragraph are subsequently modified (other than by reason of death or disability)...before the close of the 5-year period beginning with the date of the first payment and after the employee attains age 59 ½, or ...before the employee attains age 59 ½, [then]... the taxpayer's tax for the 1st taxable year in which such modification occurs shall increased by an amount...equal to the tax which...would have been imposed, plus interest for the deferral period."*
>
> *IRC §72(t)(4)(A)*

Here lies the trap regarding all SEPP plans. The above essentially says that if you modify your SEPPs, for any reason other than death or disability, before the passage of at least a 5 year period and attaining age 59 ½, then the 10% surtax will be imposed on all of the distributions plus statutory interest. This is absolutely critical; so please allow some re-emphasis. If a taxpayer modifies (read changes) the annual distributions before the passage of five years and attaining age 59 ½; then the 10% surtax, plus interest will due on ALL DISTRIBUTIONS; not just the "modified" distribution. By way of example, assume a taxpayer commences a SEPP plan in 1995 at age 50 distributing $50,000 per year. In 2002, at age 57, the taxpayer dutifully distributes the $50,000 and additionally distributes another $10,000 from the same IRA for some other purpose. This is a modification! The additional taxes and interest due will be in the neighborhood of $50,000 to $60,000. In short, as we will learn through the remainder of this text, the single word "modified" is extremely important; e.g. a circumstance that we want to avoid at all costs.

We can now develop a working definition of SEPPs as follows: A series of payments or withdrawals from deferred account(s) that can either be exactly equal or potentially somewhat dissimilar, that occur annually or more frequently, and continue unmodified for a minimum time period of five years or until the taxpayer attains the age of 59 ½, whichever is greater. As a result, if we establish a payment stream that meets this definition, we should be able to do so and avoid the 10% surtax.

There are some other fairly obvious rules that come about through coordination with other code sections:

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[40] The IRC frequently uses the term "employee" in the context of a participant in a qualified plan. Unless otherwise noted, the term "employee" and the term "owner" of an IRA are synonymous.

- The 10% surtax, if and when applied, only applies to that portion of the distribution that is otherwise includible in the gross income of the taxpayer. As an example, if one were to withdraw $10,000 from an IRA and that $10,000 was composed of $8,000 of untaxed dollars and $2,000 of after-tax dollars; then only the $8,000 is includible in the taxpayer's gross income; therefore the surtax would only be $800, not $1,000.

- In order to take distributions from a qualified plan, the employee must have separated service from the employer[41].

- Coordination between exceptions #1 and #4. From our discussion above, it is pretty clear than when a taxpayer, aged 50, commences SEPPs and then modifies[42] those payments before age 59 ½ then he will owe the 10% surtax plus interest on 100% of the distributions. What about a taxpayer, aged 57 who commences SEPPs and continues them to age 59 ½ and then modifies the SEPPs after age 59 ½? The taxpayer is over 59 ½ but has failed the 5-year rule as required by IRC §72(t)(4)(A). As a result, the distributions made after age 59 ½, even though a modification of the original SEPP plan are okay; however, the 10% surtax and interest is imposed on the 2 ½ years worth of distributions made during the time period when the taxpayer was aged 57 to 59 ½.

Virtually all of the remainder of this text is devoted to proper SEPP plan design and therefore avoidance of the 10% surtax. Unfortunately, regular income tax (always federal and sometimes state tax as well) is due. After all, the contributions, by employees and employers, as well as all of the earnings on those contributions have never been taxed. Thus, we tend to call all of these accounts and assets as "deferred asset accounts", not "tax free" accounts. Taxation of these accounts has been deferred[43] (not eliminated or forgiven) during their accumulation years. Now that the taxpayer wants to commence withdrawals, the tax deferral period ends and Congress, through the arm of the Internal Revenue Service, is standing at your door ready to finally collect.

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41 IRC §72(t)(3)(B).

42 A voluntary cessation of payments is considered a modification.

43 For those taxpayers who are participants in any kind of §401 plan with your employer; you might want to take a close look at your pay stub. You will notice that your contributions are not federally or state income taxed. However, those contribution dollars are taxed for FICA/Medicare (roughly 7.65% on the first $147,000 of wages). As a result, when distributions occur in later years, the income tax becomes due but no FICA/Medicare taxes are due as these taxes were paid years ago when the contribution was made.

INTERNAL REVENUE SERVICE PUBLICATIONS

There are four IRS publications that are absolutely critical in the design of SEPP plans. They are:

- Publication 590B. This is the IRS's seminal text (approximately 70 pages in length and is updated annually) on IRA distributions. Everyone reading this text should have a copy of this publication. If you have not already done so, stop reading now, go to the www.irs.gov web site into the publications section, select Publication 590B[44] and print it.

- Notice 89-25; Q&A 12. This is the IRS's originating publication in 1989 and establishes three fundamentally different computational schemes for SEPPs. Most of Notice 89-25 has been superceded by subsequent publications[45].

- Revenue Ruling 2002-62[46] was the authority or bible on SEPPs which became mandatorily effective on January 1, 2003. This ruling provides substantial details on allowable computational methods; "modification" escape mechanisms and life expectancy tables that are required to be used.

- Notice 2022-6, issued in mid-January, 2022, is now the most recent authority on SEPP plans. Frequently, this Notice is repeat of Revenue Ruling 2002-62 but in some important areas presents some new rules as well as new features for SEPP plan decision-making. When these difference present themselves they will be separately identified.

TAX COURT CASES

Where else can we look for authority on SEPPs? The United States Tax Court and Federal District Courts have heard and ruled on several cases pertaining to SEPP plans. The are several of direct importance:

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44 Pub 590B is an Adobe Acrobat "pdf" file. As a result, you will need a copy of Adobe Acrobat Reader v4 or v5 in order to download and print this file. If you do not have a computer that is Internet enabled, call the IRS and request a copy of this publication by mail.

45 Unless specifically noted to the contrary, the reader should presume that with respect to a specific condition or rule, that portion of Notice 89-25 has been updated and therefore over-ridden by some language found in Revenue Ruling 2002-62 and/or Notice 2022-6.

46 Internal Revenue Bulletin 2002-42, 710; October 21, 2002.

- Arnold v. Commissioner[47]. The real issue decided in this case was the precise definition of the phrase "...the 5-year period beginning with the date of the first payment...[48]" The Arnold's contended that "5-year period" meant five calendar tax years as they had taken five equal annual distributions in 12/89, 1990, 1991, 1992 and 1/93; thus spanning five tax years but only 38 calendar months. The Arnold's then took an additional distribution later in November, 1993, after Mr. Arnold's 59 ½ birthday contending that they had met the "5-year" rule. The Commissioner contended that a literal interpretation was appropriate in that any language referencing a "tax year" was absent in the IRC and that therefore a "5-year period" that commenced with the first payment therefore defined a period from 12/89 through 12/94. The tax court agreed with the Commissioner thus determining that: "It is evident that the 5-year period in §72(t)(4) closes at the end of 5 [calendar] years from the date of the first distribution. It does not end on the date of the 5th annual distribution...". Thus, the extra distribution in November, 1993 constituted a "modification" which therefore disallowed all the distributions from 12/89 through 1/93 and imposed the 10% surtax plus interest.

- Farley v. Commissioner[49] was a pro se representation (in the author's opinion, never a good idea when dealing with the IRS in Tax Court); where Farley attempted to persuade the court that 29% was a reasonable interest rate assumption. Even though the pertinent transactions all occurred prior to December 31, 2002; the court was not impressed ruling:

  - The tax court is NOT bound by the then prevailing Notice 89-25 and therefore by implication would neither be bound by Revenue Ruling 2002-62. In this case the Court emphasized the non-binding nature of Notice 89-25, but permitted the parties to proceed under mutual consent.

  - Notice 89-25 contained the language: "at an interest rate that does not exceed a reasonable interest rate on the date payments commence." As a result, the court ruled that Farley had used a growth rate / interest rate assumption in the amortization method that was too high; specifically the Court said: "in contravention of the legislative purpose underlying IRC §72(t)."

  Needless-to-say, in this author's opinion, the 29% interest rate was pure fiction; e.g. simply that required rate of interest needed to mathematically support the annual distribution amounts taken by Farley based on his IRA balance and age. Neither the IRS nor the Tax Court were fooled.

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[47] 111 TC 250; 1998 U. S. Tax Court. As mentioned earlier, here is case that hinged on an interpretation of the IRC; not an interpretation of an IRS opinion or publication. You can already guess the outcome.

[48] IRC §72(t)(4)(A)(ii)(I).

[49] T.C. Summ. Op. 2003-43 WL 1923472.

- Wood v. Commissioner[50] is one of several landmark cases on the issue of "content versus form" as it relates to deferred accounts and their taxation. In this case Wood entered into a (contractual) relationship with the trustee (Merrill Lynch) to properly process his lump sum distribution from Sears comprising of two components; cash and almost 2000 shares of Sears stock (at that time very valuable). Wood completed all of the proper forms; deposited both the cash and stock into an existing after-tax account with trustee and finally instructed the trustee to transfer the cash and the stock into Wood's newly created IRA account with trustee.

  The trustee did transfer the cash correctly but acted incorrectly (essentially committing a breach of fiduciary duty) by failing to move the stock. More than 60 days passed (the IRC §408(d)(3) rollover time window) and later: (a) discovered its error; (b) corrected its error by "journaling" the stock from Wood's regular account to his IRA account.

  The IRS applied the 10% surtax claiming that the stock had not been rolled over in a timely manner (which technically it had not). Further, the IRS asserted:

  (A) Wood was "bound by Merrill Lynch's bookkeeping error". (essentially the sub-contractor theory).

  (B) Wood was entitled to no relief because "he did nothing to correct the mistake even though he received several monthly statements which should have alerted him..." (The notice theory).

  The court rejected both of the IRS's claims, instead stating: "if this is determined to attributable to a mere bookkeeping error that failed to properly reflect the transaction, it will not control the resolution of this case. It is well settled that where book entries are at variance with the facts [read Wood's intent in this case], the decision must rest on the facts...It follows that a bookkeeping error does not alter the rights and responsibilities between parties to a transaction."

  By taking this position, the court is further implicitly saying several other things:

  (A) Intent and instruction by a taxpayer to his trustee govern over the transactions or non-transactions and related accounting/bookkeeping entries of the trustee.

  (B) Implicitly, the trustee was correct in correcting the error once discovered even though the correction date was long past the 60-day window for rollovers.

  (C) It is correct to overlook or look past the "constructive receipt" theory in that Wood could have (but did not) spend or covert his shares of Sears stock while those shares resided in his regular brokerage account.

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[50] 93 TC No. 12, 93 TC 114.

One might properly ask why we should care about Mr. Wood as his case has nothing to do with substantially equal periodic payment plans. The answer lies in the resolution of the "content over form" issue, easily restated as: "What did the taxpayer intend to do? And, can the taxpayer prove up his intent?" meaning that taxpayer intent generally governs over what the documents or resultant transactions / bookkeeping entries might reflect. This issue will become critical in later chapters as we work on how to correct errors in the execution of a correctly designed distribution plan.

PRIVATE LETTER RULINGS

What is a private letter ruling (PLR)? A PLR is essentially the making of law one taxpayer at a time. A taxpayer may make a PLR request to the Assistant General Counsel's Office of the IRS, essentially the IRS's internal legal department. During the period of 1988 through 2021, the IRS issued approximately 160 private letter rulings on pertinent §72(t) issues[51]. Although "private", meaning for the use of the submitting taxpayer only, these PLRs are published[52] so that professionals can read them in order to gain a keener insight into the IRS's thinking on details as well as policy. Unfortunately, we face two hurdles or dilemmas when looking at PLRs:

- Every PLR issued starts with the language: "This document may not be used or cited as precedent. §6110(j)(3) of the Internal Revenue Code." Roughly translated, this means that we can not rely upon a PLR which was necessarily drafted with the submitting taxpayer's facts & circumstances in mind, as precedent for our own purposes. There are actually good reasons for this language: one, some other taxpayer went to the time & expense of obtaining the PLR; therefore it his & not ours for the taking. Secondly, and more importantly, PLRs are a response of law (or at least the IRS's position of law to which they are essentially bound) to a particular and fixed set of facts & circumstances from a single taxpayer. Rarely are circumstances identical and it would be much to easy for taxpayer #2 or taxpayer #156 to use taxpayer #1's PLR with a slightly modified fact set. Unfortunately, it can be that slight modification of facts that nullifies or reverses the essence of a PLR.

  A logical question to ask is why would we even bother to read PLRs if we can not use them? We read them for two reasons: one, the PLRs are intentionally published as a mechanism for outsiders to learn the thinking and leanings of the IRS on pertinent issues without the IRS being "legally bound" to others; e.g. a formalized way to provide a peek in the box; secondly, we can often find the same issue repeating itself through numerous PLRs where the issue is not related or tainted by specific taxpayer facts & circumstances. This then

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51 At least Legal Bitstream found 160 cases during this time period.

52 A published PLR is done so in redacted form, meaning that names, dates, amounts, etc. are removed from the PLR in order to protect the privacy of the submitting taxpayer. In addition, a substantial portion of the detail facts & circumstances as submitted by the taxpayer may be deleted from the published ruling. Thus, PLRs are a valuable tool from a theory perspective only; and never from a facts & circumstances perspective.

becomes a mechanism to extract the pertinent theory from a group of PLRs upon which we may tentatively rely. As we march through subsequent chapters of this text, you will find citations to groups of PLRs that are essentially a confirmation mechanism or affirmation of our basic thinking. In other areas there may be one or two PLRs indicating that possibilities exist on a certain issue. We will clearly point these out as they occur and differentiate between them.

- Beyond the above, we face an even greater challenge in the examination of PLRs. The 160 or so PLRs issued 116 were done so in reference to IRC §72(t) and Notice 89-25; the governing law from Spring, 1989 through December, 2002. The IRS issued Revenue Ruling 2002-62 in October, 2002 with a mandatory effective date of January 1, 2003 which expands and in some cases overturns Notice 89-25. Do we therefore throw away all 116 of those PLRs because new law is now in effect? Yes, but! We discard all 116 rulings and then very carefully re-read all of them looking for ruling sets that meet two criteria:

  - One, the ruling, or group of rulings, was deciding an issue or interpretation of the Internal Revenue Code and not an interpretation of old Notice 89-25; remembering that Notice 89-25 has been superceded; however, IRC §72(t) survives as it has not been changed.

  - Two, the rulings at hand were deciding an issue outside the boundaries of both Notice 89-25 and Revenue Ruling 2002-62[53]. Said another way, if a group of rulings discuss an issue that is important to the design of a SEPP program but the issue is not mentioned in either the Notice or the Ruling; then, that group of rulings likely survive even though the PLR publication dates precede October, 2002. Some examples are in order:

    - Multiple rulings in the 1990's approved the use of UP-1984 as a "specifically approved" mortality table from which various life expectancies could be computed. Revenue Ruling 2002-62 specifically says in part: "The life expectancy tables that can be used...are..." to the exclusion of UP-1984. Here is a case where the new ruling is very specifically "on point"; therefore, commencing January 1, 2003, the use of UP-1984 is prohibited irrespective of its prior approval.

    - Other issues, such as the use of "stub periods", launching of multiple SEPP programs and so forth are not mentioned, discussed or inferred in either the Notice or the Ruling. As a result, these tactical topics are outside the scope of both documents. In these cases we may, albeit carefully, rely upon PLRs

[53] Both Notice 89-25 and Revenue Ruling 2002-62 are computational method, interest rate and mortality table oriented. Thus their scope is necessarily limited and does not cover a number of other ancillary issues which are nonetheless still important in the tactical planning of SEPP programs.

that focus on these areas.

- Further, we now face newly issued Notice 2022-6 which in some cases overrides portions of Revenue Ruling 2002-62 and in others does not. Despite this Notice's "volcanic" nature, it is way too soon for the issuance of PLRs on new issues raised by it.

The issuance of Revenue Ruling 2002-62 necessarily reduced the body of knowledge and law on the whole §72(t) issue. This is, in a way, unfortunate but necessary. As indicated earlier, we will sometimes go word-by-word through the new ruling to determine its true meaning. Further, the revenue ruling was a major improvement, sometimes in flexibility; sometimes in detailed and fairly strict guidance; but, in all cases a major improvement over Notice 89-25 for which we will gladly trade away groups of old PLRs which are now overruled.

In light of all of the above, all PLRs still start with the caveat: "This document may not be used or cited as precedent. §6110(j)(3) of the Internal Revenue Code." IRC §6110(j)(3) has been enacted as law for multiple decades and was therefore passed by some Congress and signed by some President in the distant past. However, we fortunately have a tripartite form of government in which the federal court system plays an integral role. Sometimes the federal courts do not agree with Congress or the IRS (a member of the executive branch) in this case saying:

> "Even though revenue rulings do not have the force of law and are merely statements of the Commissioner's litigating and administrative position, Dixon v. United States, 381 US 68, 73 (1965), such rulings constitute a body of experience and informed judgement to which courts may properly resort for guidance in the interpretation of revenue statutes and regulations...[54]"

Said another way, just because the IRC says that PLRs may not be relied upon as precedent does not necessarily make it so! The U.S. Tax Court has definitively ruled essentially striking down or at least decreasing the absolute effectiveness of IRC §6110(j)(3). This author does not suggest that it would be a rewarding experience to face the Internal Revenue Service in tax court on an IRC §72(t) issue. Far from it. However, should a taxpayer be forced into such a position, at least the taxpayer and counsel will have the ability to rely upon the theory as expressed or implied in PLRs particularly in light of the brevity of IRC §72(t)(2)(A)(iv) as well as the absence of any regulations in this area of the Code. Said another way, we as taxpayers have the Code, a couple of page Revenue Ruling (which by its brevity must be incomplete) and 160 some-odd PLRs. Where else might the prudent taxpayer (and the courts) turn to for relevant and meaningful interpretation of the law?

Lastly, IRC §72(t) has always been an individual taxation oriented code section by virtue of its topics. Conversely, corporations, partnerships, trusts have little use for §72(t) as there is little to no applicability. As a result, virtually all of the PLRs issued from 1988 through early 2006, some 134 PLRs, (84% of the total) were submitted by individual taxpayers for two reasons: one, specific answers were

[54] Anderson & Latos v. Commissioner 123 TC 2004.

needed regarding the tactical and correct way to implement distribution plans; two, most individual taxpayers could afford to pay to get correct and official answers. Through January 31, 2006, PLR submission fees ranged from $600 to $2600 depending on the submitting taxpayer's adjusted gross income. Effective February 1, 2006, fees for PLRs rose to $9,000. This means that a PLR on a §72(t) matter can now easily cost $14,000 or more when factoring in the costs associated with preparing the submission when added to the filing fee to the IRS.

As a result, in the last 13 years, only 26 PLRs have been issued, a pace of 2 per year approximating 1/4th the pace of 2005 and earlier. None have been issued since 2015. This author will not editorialize often, but this a situation that absolutely demands comment: This is an abomination committed by the executive branch of our federal government bordering on violation of constitutional rights. Essentially, we are forced to live with a very limited set of primary and secondary authorities after which we are forced to make educated guesses primarily because we, as practioners in this area cannot find many individual taxpayers with sufficiently deep pockets to fund the PLR process.

QUALIFIED PLAN VERSUS IRA

The entire issue of "qualified plan" versus IRAs is complex. IRC §72(t) applies to all "qualified retirement plans" as defined in IRC §4974(c). §4974(c) includes all of the usual suspects including: profit sharing plans, CODAs also known as 401(k) plans, as well as all types of IRAs which are qualified retirement plans under IRC §408(a). Thus, so far, all plans are eligible for treatment under all subsections of IRC §72(t). But wait, IRC §72(t)(3) comes along and limits some exceptions to all qualified plans excluding individual retirement plans; e.g. IRAs. Further, some more recent additions to IRC §72(t) have been enacted for only IRAs and/or for only retirement plans excluding IRAs.

In summary, each taxpayer now needs a roadmap correlating which exceptions are eligible for use dependent on type of retirement account[55]. Furthermore, there are currently fourteen separate exceptions, meaning 14 separate sets of rules under which a taxpayer may make a withdrawal from a retirement plan and not be subject to the 10% surtax. Thus some cautions:

(1) Each exception has its own set of rules and qualifiers. Taxpayers need to be extremely diligent in their analysis of those rules to insure complete, "inside the boundaries" qualification.

(2) There are no other exceptions, express or implied. Many people have confused the "hardship withdrawal" guidelines for 401(k) plans; e.g. specific situations under which an employed, plan participant may be granted access (meaning a limited ability to distribute) in order to satisfy a hardship. These hardship rules are plan rule oriented, not tax oriented. This means that an employed plan participant may seek hardship access to their 401(k) funds, the

[55] In this author's opinion; this bifurcation of exceptions across retirement plan types is absurd. However, this is not the doing of the Internal Revenue Service. Instead, this is the law of land as passed by Congress and signed by a President.

hardship is approved, monies are distributed and the distribution is still treated as ordinary income and the 10% surtax still applies because even though a hardship existed, the hardship did not meet the requirements of one or more of the 14 exceptions listed.

Following is a table of the exceptions remembering that no other exceptions exist.

Exception #	IRC Code §	Title	Qualified Plan	IRA
1	§72(t)(2)(A)(i)	Age 59 1/2	Yes	Yes
2	§72(t)(2)(A)(ii)	Death	Yes	Yes
3	§72(t)(2)(A)(iii)	Disability	Yes	Yes
4	§72(t)(2)(A)(iv)	SEPPs	Yes	Yes
5	§72(t)(2)(A)(v)	Separation of Service At 50 or 55	Yes	No
6	§72(t)(2)(A)(vi)	§404(k) Dividends	Yes	No
7	§72(t)(2)(A)(vii)	Tax Levies	Yes	Yes
8	§72(t)(2)(B)	Medical Expenses	Yes	Yes
9	§72(t)(2)(C)	QDROs	Yes	No
10	§72(t)(2)(D)	Health Insurance Premiums	No	Yes
11	§72(t)(2)(E)	Higher Education	No	Yes
12	§72(t)(2)(F)	1st Home Purchase	No	Yes
13	§72(t)(2)(G)	Qualified Reservist	Yes	Yes
14	§72(t)(2)(H)	Child Birth & Adoption	Yes	Yes

CHAPTER 2 --- COMMON SEPP CONCEPTS

Before we delve into the intricacies of individual SEPP programs, we should spend some time on some basics and concepts common to all SEPP programs. Central to all deferred accounts is the concept of timing. In exchange for the tax deferral granted in earlier years, each taxpayer implicitly agreed to live by Congress's implied definitions of the word retirement. It does not matter if we like or dislike the Congressional definition or are financially able to retire early; we all signed on the first day we opened an IRA or made a contribution to a §401(k) plan.

UNEARNED ORDINARY INCOME

Congress has effectively legislated that withdrawals from deferred accounts are the logical equivalent of retirement and that retirement is essentially a time period or periods during which a taxpayer's unearned[56] income replaces earned income. Earned income is easy to understand; it is those monies received, typically from an employer, for your personal services, e.g. wages, salary, bonuses and the like. Further, each taxpayer is taxed on earned income when it is earned except for contributions to deferred asset accounts, IRAs, §401(k) contributions and the like. By law, all of the contributions you make, contributions your employer may make on your behalf, as well as any and all earnings and asset appreciation that occur, are all reclassified as unearned income. As a result, some years later, the contents of your deferred accounts are as yet untaxed. Neither the manner, nor the original source of the contributions nor the manner in which asset appreciation occurred is of significance. As a result, all subsequent distributions are taxed as ordinary income using the then present graduated tax rates. As an aside this represents some planning opportunities:

- Generally, if given the option, one would hold assets for long term capital appreciation in a regular after-tax account so that sales of securities will be afforded long term capital gains treatment at lower rates. Additionally, qualifying dividend (but not interest) producing securities are also candidates as dividends are now afforded a maximum tax rate of 15%.

- Conversely, interest income and non-qualified dividend income producing assets are more logical candidates to held in a deferred account as receipt of the income will ultimately be taxed identically, just at a different time.

- Tax free income producing assets such as tax-exempt bonds should never be held in a deferred account. Similarly, "mixed class" assets such as real estate investments, master limited partnership ("MLPs") are generally not well suited for deferred accounts; not because they are poor investments, but, rather they will often lose an important tax feature inside of a deferred account that was potentially one of its attractions in the first place.

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[56] We all know that you really did earn the contents of your deferred account. The distinction being made here is one of semantics and attempting to cause a division between earned income and other types of income. More specifically, all earned income is FICA/Medicare taxed and income taxed when declared. Conversely, unearned income is income taxed when declared but is not FICA/Medicare taxed.

AGE WINDOWS

In concert with indirectly defining the word "retirement", Congress has created three time windows:

- Before age 59 ½.
- Between ages 59 ½ and 71 ½.
- On and after age 72.

Before age 59 ½ is called "early retirement". During this period, Congress had made it intentionally difficult to make deferred account withdrawals. It matters not that you were professionally successful and started a personal savings plan early in life. Congress has deemed that individuals leaving the earned income workforce and substituting unearned income before the age of 59 ½ are early retirees. Further, by implication, Congress is interested in discouraging this activity. Therefore, it imposes extra taxes (namely the 10% surtax) on those individuals who make these early withdrawals. Fortunately, Congress did give us some narrow windows of opportunity.

Stage two, from ages 59 ½ to 71 ½ is typically called "normal retirement". During this time period, taxpayers typically have unlimited freedom to make or not make deferred account distributions. The only requirement is that the taxpayer must pay ordinary federal income taxes. As a further aside, this does present some tax planning opportunities:

- Consider changing your state of residency during periods of potentially high deferred account distributions to a state that either exempts or materially credits retirement distributions. Similarly, there is nothing wrong with a state that has no income tax.
- Consider maximizing stage two period distributions to maximize lower tax bracket usage. As an example, if you are in low end of the 25% federal tax bracket, consider withdrawing additional amounts, so to speak, early and reinvesting the net after-tax proceeds in capital gains creating assets or tax free assets. This is particularly true for taxpayers with large IRA accounts that can be projected to materially grow such that commencing at age 72 the minimum required distributions will catapult one into a higher tax bracket.

Stage three really doesn't have a name, but it commences at age 72. At this point, Congress reverses itself and instead of making distributions difficult, as they are in stage one, Congress now mandates minimum withdrawals[57] even though you may not want to make them. These are called the required minimum distributions or RMD's which start at approximately 3.6% of your aggregated IRA balances commencing at age 72 and rising to 5% at age 80 and 8.2% at age 90. Not meeting the RMD's is extremely

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[57] IRC §401(a)(9)(c) & §4974(a).

painful to the tune of a 50% excess accumulations tax to the extent that your distributions fall short of the RMD in any one year.

THE ACCOUNT CONCEPT

A taxpayer (or taxpayer & spouse) is most often treated as a single taxable entity. Thus, if we think about IRS Form 1040, it starts to make some sense. Through the use of a blizzard of subsidiary forms (one for interest & dividends, another for capital gains and yet another for farm income) all taxpayer income eventually flows upwards and will land somewhere on Form 1040. It is on this form that the whole taxpayer's income situation is revealed and the income tax is imposed.

IRC §72(t) and SEPPs work in the exact opposite manner. Instead of treating the taxpayers as a single taxable entity, the taxpayer's accounts are fragmented into pieces. As we will learn later, this is actually an advantage as SEPPs are structured, evaluated and used on an account-by-account basis[58]. For example, it is quite conceivable that a taxpayer might have three, or six or even nine separate deferred accounts. To commence a SEPP program, this taxpayer faces two fundamental choices:

- Select one and only one of the nine deferred accounts[59] and commence a SEPP program on only that account. The other eight accounts are held on the sidelines for future use at future dates.

- Select more than one of the accounts up to and including all nine of the accounts by creating a "SEPP universe[60]". Let's assume accounts 1,2 & 3 are selected holding accounts 4 through 9 on the sidelines. The SEPP program is computed using the sum of the balances of accounts 1,2 & 3 resulting in a determined annual distribution amount. Going forward, that annual distribution amount can be made in any proportion from any of the three accounts defined in the universe. Once the universe is defined and the SEPP withdrawal is made, the contents

58 PLR 89-46045 is the 1st of multiple PLRs that dealt with the issue of taxpayers with multiple IRA accounts. In specific, the IRS ruled: "during the period of distributions...you need not take distributions from your other IRAs or consider the account balances of those IRAs when calculating the amounts of the annual distribution necessary under §72(t)(2)(A)(iv)." This same concept is addressed, albeit more clearly and thoroughly, in PLR 90-50030 in which the IRS ruled: "IRC §72(t)(2)(A)(iv) does not require that plans be aggregated to calculate a series of substantially equal periodic payments. Accordingly...we conclude that the monthly distributions from the rollover IRA...are not subject to the 10% additional tax...regardless of whether similar distributions are made from other regular IRAs maintained by you...and that the account balances of the other IRAs need not be considered when calculating the amounts of the annual distributions necessary...". This same issue of multiple IRA accounts and selecting one or more for a SEPP program and exclusion of other IRAs is addressed several more times in PLRs. Each time the IRS's response has been consistent with the above.

59 See PLR 2003-09028 wherein the IRS said: "§72 and the applicable regulations do not require the aggregation of all IRAs owned by the same taxpayer for purposes of [applying] §72(t)(2)(A)(iv)."

60 See PLR 91-23062. In this case, a taxpayer logically aggregated the balances of two of his IRAs for distribution amount computation.

or membership of the universe is fixed and can not be changed. For example, accounts 4 & 5 can not be added to the universe at a later date; further, the annual distribution amount must be withdrawn from IRAs 1,2 or 3 only.

This concept of fracturing the taxpayer's deferred accounts only applies before age 59 ½ and will work to our advantage in designing multiple SEPP programs that can run concurrently or launch at different times. Between age 59 ½ and 72 this concept is irrelevant as withdrawals are unstructured and penalty free. When the taxpayer reached age 72, Congress again reverses course and requires that all deferred accounts be aggregated together, not physically, but for the purposes of measurement and computation of the annual required minimum distribution amount[61].

To conclude, the seminal ruling on this issue is PLR 95-25062 in which a taxpayer received a qualifying lump sum distribution from an employer plan and placed 100% of that distribution into an IRA. Then, the taxpayer transferred dollars from IRA #1 into newly created IRA #2 and IRA #3. Lastly, the taxpayer decided to commence a SEPP plan based upon the sum of IRA #2 and IRA #3 leaving IRA #1 untouched (and therefore available for other future plans and purposes).

The IRS ruled favorably saying: "We further conclude that the periodic payments derived using the proposed methodology (the annuity method in this case) may be computed with respect to the aggregated account balances of IRA #2 and IRA #3 only, without taking any other IRAs owned by the taxpayer into account."

INDIVIDUAL OWNERSHIP

Deferred accounts are always owned individually[62]. There is no such thing as a jointly owned IRA. Thus, in addition to the account concept discussed above, married taxpayers are split apart when considering SEPPs. This is actually good news. As a result, one spouse can commence SEPPs while the other spouse does not. Further, the application of SEPP rules, such as duration and the age 59 ½ rule are applied individually to each SEPP program launched by each spouse.

RELATIONSHIP TO EARNED INCOME

During a working career, most taxpayers more than likely received earned income in the form

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61 IRC §408(d)(2)(A) & (B).

62 It is easy to forget that the "I" in IRA stands for "individual".

of a paycheck from an employer. Conversely, SEPPs are classified as unearned income[63]. These two types, although taxed similarly, are unrelated. Neither type of income prohibits the creation or receipt of the other. Thus, it is perfectly okay to be receiving SEPPs from your IRA and at the same time be gainfully employed (or self-employed) as you so chose. This also presents some tax and financial planning opportunities with respect to commencing SEPPs and then launching into a new career or business.

REVERSIBILITY AND ERRORS

In many cases, the Internal Revenue Code or the regulations provide methods for a taxpayer to reverse course, sometimes years after an initial tax decision has been made. This is NOT one of those cases. Within our general context of discussion, SEPPs are never reversible. Additionally, the new law of the land is that each taxpayer is now allowed one rollover per year irrespective of the number of IRAs owned by the taxpayer. This implies a couple of strategies:

- One can use the one annual rollover to quickly correct (within 60 days) an unintentional over distribution.
- Assume a taxpayer with ½ dozen IRAs. It makes good sense to create one IRA as the designated SEPP IRA and then collapse all of the other IRAs into IRA#2 for future use. This then preserves the single annual rollover for when it might truly be needed.
- Rely upon Wood v. Commissioner for those situations where evidence can be produced establishing a sub-contractor has erred.

The above is admittedly a pretty short list. Therefore, the author suggests that more time be committed to the initial avoidance of errors thus not requiring any reversing transactions. To wit:

- Plan, plan and then re-plan your cash flows as well as SEPP program design. When you think you're done, re-plan it again.
- Document your SEPP program in a letter or contract to yourself spelling out all of the details right down to the plan assumptions, account numbers & balances, etc.

63 As mentioned earlier, there is no prejudice intended in the use of the terms "earned" and "unearned". It just a matter of labeling to keep clear how present and future period taxation will take place. Further, it is a common event for a taxpayer currently making SEPPs to also want to make an IRA contribution. This is not permitted, at least not from SEPP distributions. Instead, the taxpayer must have earned income from some other source and then make an IRA contribution based on that earned income.

- Taxpayers who are the least bit hesitant or uncertain should obtain a professional review of the intended program including consideration of receiving an opinion letter from a licensed professional CPA or tax attorney.

IRC VERSUS IRS AND THE LOTTERY

This is as good a time as any to raise two important but unrelated topics: one, the IRC versus the IRS, and two, the concept of playing audit lottery:

- By the time the reader reaches the end of this text, it will become apparent that there is often considerable latitude in the implementation of some of these exceptions. Then, in another circumstance it will appear to be as if the rules switch around and become unduly harsh and restrictive; e.g. why measure one's 59th and ½ birthday to the day; shouldn't attaining age 59 ½ sometime in the taxable year be sufficient? The reason for this lies in determining who or what is the prevailing authority on the question or issue at hand. When language is embodied in the Internal Revenue Code, then the Internal Revenue Service and the courts have no alternative but to take a very literal interpretation of the law[64]. Conversely, there are many circumstances where the IRC is vague or may embody language like, "based on the regulations as issued by the Commissioner." In this later case, decision-making authority is actually transferred from Congress to the IRS on the belief that the IRS is better at examining the details of a situation and is better qualified to issue appropriate regulations and opinions. In these later cases, we will find considerable additional flexibilities afforded to taxpayers.

- Everyone would like to win the Powerball lottery. However, it is said that this is about as likely as being struck by lightning three times on the same day. However, you may wish for the lightning instead of winning the IRS lottery. Should your social security number magically turn up[65], it is very important to know which lottery you have just entered.

  In the arena of auditable issues on IRC §72(t) there are really two different environments: the IRC lottery and the IRS lottery. In the same context as above, if you are audited and the central issue to be resolved lies in an interpretation of the IRC as drafted by Congress, **YOU WILL LOSE!** The IRS as well as tax courts and federal district courts will take a literal and restrictive construct of the IRC language. In short, there is zero maneuvering room. Conversely, if the central issue lies in the interpretation of the IRC through the IRS's issuance of regulations or rulings, you may then stand a chance, modestly greater than zero

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64 Think of it this way. Congress takes a fairly dim view of affairs when an executive branch employee, even if he is the Secretary of the Treasury, decides that something in the Internal Revenue Code means something different than what Congress wrote.

65 There is absolutely no direct evidence to suggest that taking early distributions from your deferred-asset accounts in any way influences or increases your likelihood of an audit. However, should you be audited, there is a 100% probability that your SEPP withdrawals will be closely examined to insure full compliance.

of prevailing; however, that chance still remains relatively small.

Sometimes the temptation to venture into "audit land and the gray areas of the IRC" may appear to be a wise business decision. This is not one of them. As we have discussed throughout this text, the body of knowledge and authority is not in the taxpayer's favor. Further, in this particular section of tax law, there are virtually no corrective measures available to the taxpayer when the IRS prevails. There is no way, or only very limited ways, to put back the improper distributions and amend your tax returns. Lastly, there isn't even any negotiating room in the computation of the surtaxes and statutory interest due. In summary, IRC §72(t) is not the place to push the envelope as the downside risks are substantial and almost always, non-negotiable.

PENALTY COMPUTATIONS

Almost all of this text is explicitly devoted to avoiding the surtax. Nonetheless, a common characteristic of all SEPP programs is the danger that, for whatever reason, the IRS will examine and disqualify your SEPP program therefore applying the surtax & interest.

> *"...the taxpayer's tax for the 1st taxable year in which* ***such modification*** *[emphasis added] occurs shall be increased by an amount, determined under regulations, equal to the tax which (but for paragraph (2)(A)(iv)) would have been imposed, plus interest for the deferral period."*
>
> *IRC §72(t)(4)*

What does the above mean? This is essentially a "look back" tax that says that if a "modification" occurs, then the additional tax is going to be immediately due in and for the same tax year in which the modification occurred. Further, this additional tax is computed by going back to the 1st year in which the SEPP program commenced and for that year and every intervening year recomputing the tax due for each year by applying the 10% surtax. Thus, we end up with an additional tax due for each year of the SEPP program since commencement. Secondly, for each year that is not the current year, statutory interest is charged as a further penalty for not having paid the additional tax when originally due.

For example, assume a taxpayer, aged 52, commenced SEPPs of $10,000 per year and continued the program for five years, the year in which he attains age 57. In year six, when the taxpayer turns 58, he withdraws $20,000. This would clearly be classified as a modification that violates the greater of 5 years or age 59 ½ rule. Given that he has already completed six years, he would owe an approximate penalty of $10,200.

Please note that the 10% surtax plus interest is not only due on the modified withdrawal; instead a modification has the effect of disallowing the entire distribution stream from inception; thus the 10% surtax is imposed on all amounts withdrawn. As a result, if a taxpayer is ever tempted, typically by a very material change in personal circumstance or finances, to intentionally modify their SEPPs, they should clearly do so early in the SEPP program as opposed to later[66].

In addition to the 10% surtax plus interest; one's "tax life" can potentially get worse. The IRS can also assess, to the extent applicable, an accuracy related penalty[67] equal to 20% of the additional tax owed. This additional penalty is usually imposed for either of two reasons: (1) negligence or disregard of the rules and regulations; or (2) substantial understatement of income tax due; defined as the greater of 10% of the tax required or $5,000.00. As a result, if a taxpayer modifies their SEPP plan, not only do they owe the surtax plus interest, they owe it relatively quickly if for no other reason than to avoid an additional 20% penalty.

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66 Interestingly, there is one favorable PLR issued to a taxpayer who started a SEPP plan in year 1 and took the correct distributions in years 1 & 2; then, he had some extreme fortuitous gains causing his IRA to increase ten-fold. He sought permission to intentionally bust his original SEPP plan; pay all of the surtaxes on distributions 1 & 2 as well as pay the statutory interest on the year 1 distribution. Then, he wanted to start a new SEPP plan two months later using a more recent account valuation resulting in new SEPP plan distributions approximately ten times his old ones. The IRS saw no problem here. Certainly a bit twisted but when you think through the steps it does appear logical.

67 IRC §6662 & T.C. Memo 2004-27 Norma A Cohen v. Commissioner.

CHAPTER 3 - SUBSTANTIALLY EQUAL PERIODIC PAYMENTS

It would be convenient if a taxpayer could select any amount he or she desired and simply keep the withdrawal amount equal from year to year. Unfortunately, that is not the case. IRS Publication 590B provides some guidance; however, it is incomplete[68]. To quote in part, Publication 590B informs us that:

> *"You must use an IRS-approved distribution method and you must take at least one distribution annually for this exception to apply.*
>
> *Publication 590*

However, Publication 590B does not give us all the details we need. Instead we must refer to Notice 2022-6 to get into the computational methods. Because computations are easiest to explain via example, we are going to build an assumed fact set for John Q. Taxpayer and use these facts consistently throughout the following examples.

- John is age 52 during 2022 and is married to Cathy, age 50 in 2022, who is his beneficiary.
- As of December 31, 2021, John has a total of $1,000,000 in four rollover IRAs: A with $400,000; B with $300,000; C with $200,000; and D with $100,000.
- Although Cathy has deferred assets as well, she has elected not to make any early withdrawals.
- John terminated his employment with XYZ Corp. effective in 2021, and wishes to commence SEPPs in 2022 as an income replacement.
- For simplicity, neither John nor Cathy are disabled and neither will become deceased in the next ten years.

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[68] Actually, for Publication 590B to use the language "must use" is incorrect, or at a minimum represents the IRS taking typical broad poetic license with its publications. Notice 89-25 gives us an affirmative statement: "payments will be considered to be...[SEPPs]...if they are made according to one of the methods...". Similarly, Revenue Ruling 2002-62 and Notice 2022-6 say, in part: "Payments are considered to be...[SEPPs]...if they are made in accordance with one of the three calculations...". Nowhere in the IRC or related authorities is there any language to the effect that there are only three acceptable methods to the exclusion of others or that some other methods are automatically disallowed. Thus, it is entirely possible that there are methods four, five and six which are equally acceptable.

THE MINIMUM METHOD

The minimum method[69] is described in Notice 2022-6 as follows:

> *"(a) The required minimum distribution method. The annual payment for each distribution year is determined by dividing the account balance for that distribution year by the number of years from the chosen life expectancy table in section 3.02(a) of this notice for that distribution year. Under this method, the account balance, the number of years from the chosen life expectancy table and the resulting annual payments are redetermined for each distribution year. This redetermination of the annual payment is not considered a modification of the series of substantially equal periodic payments, provided that the required minimum distribution method continues to be used and the same life expectancy tables continue to be used, except to the extent required in section 3.02(b) of this notice."*
>
> *Notice 2022-6*

Finally, some pretty straight-forward language. In order to implement the minimum method, John needs to make some decisions. First, John needs to determine "the account balance for the year". In our example, this is $1,000,000. Second, John needs to get a number from the "chosen life expectancy table[70]". In this regard, John can pick one of three tables:

- The single life expectancy table.
- The joint and last survivor table.
- The uniform life table.

There are several issues of note here: one, John must pick one of three and only three tables; second, John must make his selection of the life expectancy table once and only once; he can not switch to

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69 Readers should note the difference between the "minimum method" — which is correct, versus the "required minimum distribution method" as used in Notice 2022-6 — which is incorrect. This is plain-old sloppy writing by the IRS. The "minimum method" was originally described in Notice 89-25 and its mathematics stand to this day. Fast forward 33 years and we get the "required minimum distribution method" which by its title does not exist therefore being incorrect. What does exist, for taxpayers aged 72 and older, are required minimum distributions, "RMD's", and RMD dollar amounts are in-fact computed using the required minimum method".

70 The three permissible life expectancy tables are not made up; instead they are direct derivatives of the census performed once every ten years. The previous time these tables were changed was as a product of the 2000 census as there was insufficient changes in mortality in 2010. The newest tables were published in TD 9930 on 11/12/2020 and are required to be used commencing 1/1/2022.

another life expectancy table at a later date. Thus, John's choices become:

- The single life expectancy table --- 34.3.
- The joint and last survivor table --- 41.4.
- The uniform life table — 46.5.

So where does John get these numbers? At the moment there are three sources that are absolutely correct: (1) Google "TD 9930" and all 32 pages will pop up and provide all three tables; (2) Go to www.72tcalc.com, select "Tech Corner", then select "New 2022 Life Expectancy Tables" and the new single and uniform tables are displayed; (3) As of May, 2022, IRS Publication 590B has been updated for 2022 and the tables can be found in the appendicies @ www.irs.gov.

The rest is simple division. John can distribute $21,505 (using the uniform life table), $29,155 (using the single life table) or $24,155 (using the joint & last survivor table) in 2022. Moving forward, the minimum method requires annual recalculation. Let's assume for the moment that John selected the single life table and distributes $29,155 during 2022. On December 31, 2022 he must recalculate to determine his 2023 distribution. Further, let's assume that John invested wisely such that his 12/31/23 IRA balances total $1,060,000. John is now a year older (53) and his new divisor becomes 33.4; thus his 2023 distribution becomes $31,737; up 8.8% from the year previous. This 8.8% increase has two components; one his IRA balances increased 6% from 12/31/21 to 12/31/22; secondly the divisor dropped from 34.3 to 33.4; a 2.6% decrease. This process of annual recalculation would continue until John (ignoring Cathy's age even when using the joint life expectancy table) and only John attains the age of 59½.

Advantages --- First, on the assumption that John is a reasonably astute investor, is that John will receive a "pay increase" each year by the virtue of the numerator increasing (by investment gains in excess of the amounts withdrawn) and the denominator decreasing (by virtue of the decreasing life expectancy(ies)). Second, the minimum method is designed to last a lifetime and statistically does so. As a result, John can sleep comfortably knowing that his assets will more than likely outlive himself.

Disadvantages --- First is that this method delivers relatively low annual distributions, in the range of 3% of assets, particularly at a time when John may need higher distributions. Second, annual recalculation is required, thus creating or inserting the concept of volatility. Based on John's investment decisions as well as market performance may result in future year annual distributions that are materially smaller or larger than John anticipates or wants. Third, although not a major issue, annual recalculation does require the careful scrutiny of IRA documents (potentially from multiple trustees) and recomputation of life expectancies. Although not particularly difficult in a mathematical sense, the potential for error exists, which could result in an incorrect mathematical result[71].

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71 This author has found no ruling or other circumstance where the taxpayer was dutifully following this method and made a mathematical error resulting in a subsequent year incorrect distribution amount. On its face, such an amount would fall outside the umbrella of deemed substantially equal. What the IRS might do is unknown. Still there is no reason to tempt fate; every taxpayer should re-check his or her math twice, if not three times.

THE FIXED AMORTIZATION METHOD

Again, Notice 2020-6 gives us a concise definition:

> *"(b) The fixed amortization method. The annual payment for each distribution year is determined as the amount that will result in the level amortization of the account balance over a specified number of years determined using the chosen life expectancy table uder section 3.02(a) of this notice and an interest rate that is permitted pursuant to section 3.02(c) of this notice. Under his method, once the account balance, the number of years from the chosen life expectancy table, and the resulting annual payment are determined for the first distribution year, the annual payment is the same amount in each succeeding year."*
>
> *Notice 2022-6*

With the fixed amortization method, John is faced with three decisions. First, John must determine his account balance (we will assume the same $1,000,000); second, John must pick a life expectancy (again, the same three expectancies of 34.3, 46.3 and 41.4 are available). Third, John must pick an interest rate. In this regard, revenue Notice 2022-6 gives us additional explicit guidance[72]:

> *"The interest rate that may be used...is any interest that is not more than the greater of (i) 5% or (ii) 120% of the federal mid-term rate (determined in accordance with §1274(d) for either of the two months immediately preceding the month in which the distribution begins).*
>
> *Notice 2022-6*

Applicable federal rates are published monthly, usually toward the end of each month and can be found in a variety of Internet[73] and print locations. In our instance, let's further assume that John wants to commence monthly distributions in January, 2022; therefore the 120% of mid-term applicable federal rates for November and December or 2021 are 1.30% and 1.52% respectively with 1.52% being the greater. Or,

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72 Readers of earlier editions of this text will recall that interest rate guidance was pretty vague in 2002 and earlier with language that said: "...at an interest rate that does not exceed a reasonable interest rate on the date payments commence...". No longer; interest rates are now very specifically capped.

73 Try www.timevalue.com or www.72tnet.com Or, to be up to the moment, visit the official IRS website at www.irs.gov\tax_regs\fedrates.html.

John can pick 5%[74]. So, any interest rate less than 5% is fine, right down to zero percent if desired[75].

Assuming John selects from the single life table, we now have all the factors necessary: $1,000,000 of principal, 5.0% and a term of 34.3 years. Let's amortize. The easy way to perform the mathematics is to use Lotus, Excel or any other computer based spreadsheet product using the formula: @PMT(P,I,T) where "P" is the principal amount, "I" is the interest rate and "T" is the term. Thus, we would express this as: @PMT(1000000,.05,34.3) resulting in $61,545 per year. John's monthly distribution would be $5128.75.

What we have just computed above is **THE MAXIMUM** allowable annual distribution using the amortization method. At a zero interest rate assumption, the annual distribution would fall to $29,155; the same as the minimum method using single life expectancy. As a result, John can reasonably select **ANY** annual distribution amount between $29,155 and $61,545 simply by selecting an interest rate that causes the mathematics to perform correctly to his wishes. As an example, suppose John wanted exactly $4,000.00 per month. Using the @PMT function, John can back-solve for the needed interest rate of 3.135%% which will result in exactly $48,000 per year.

The fixed amortization method is a one time computation performed before the first distribution is made and is held constant throughout the SEPP program.

Advantages --- First and foremost, the amortization method yields substantially higher annual distribution amounts than the minimum method. In our example, a 100% increase when compared to the minimum method. Further, as of this writing, we are in a period of historically low interest rates which are accordingly reflected in the published applicable federal rates. If 120% of mid-term rate were 6.5% (as recent as the Winter of 2001), the annual maximum distribution would jump upwards to almost $74,000 per year. Second, the amortization method is variable in its application; John can pick any annual distribution amount he so chooses as long as it is equal to or less than the maximum computed; conversely, the minimum method produced only "fixed point" amounts depending on which life expectancy table was chosen. Third, the amortization method mathematics are done once thus removing the possibilities of mathematical error and potentially unwanted volatility in annual distribution amounts.

Disadvantages --- On the other hand, the amortization method does not provide the built in pay increases found in the minimum method. Secondly, there is the risk that John, through unwise investments and/or poor market performance, may prematurely exhaust or materially deplete his IRAs such that the prospect of those IRAs providing lifetime income are seriously diminished.

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74 Here is the huge change from Revenue Ruling 2002-62! RR 2002-62 did not have the "or 5%" clause. As a result taxpayers launching SEPP plans in the 2003 to 2021 era have suffered artificially low interest rate assumptions and resultant lowered annual distributions.

75 Effectively 5% becomes the ceiling interest rate allowable until such time as 120% of the mid-term applicable federal rate exceeds 5%. We think the last time that happened was Fall, 2008.

THE FIXED ANNUITY METHOD

The annuity method is also described in Notice 2022-6 as follows:

> *"(c) The fixed annuitization method. The annual payment for each distribution year is determined by dividing the account balance by an annuity factor that is the present value of an annuity of $1 per year beginning at the employee's age and continuing for the life of the employee (or the joint lives of the employee and designated beneficiary). The annuity factor is derived using the mortality rates in §1.401(a)(9)-9(e) and an interest rate that is permitted pursuant to section 3.02(c) of this notice. Under this method, once the account balance, the annuity factor, and the resulting annual payment are determined for the first distribution year, the annual payment is the same amount in each succeeding distribution year."*
>
> *Notice 2022-6*

Commencing January 1, 2003 (as opposed to earlier) the IRS forced conformity in the selection of life expectancy tables. Use of a more aggressive[76] mortality table was the major advantage of the annuitization method over the amortization method typically resulting in annual distributions being 5% to 10% higher with the annuitization method. No longer. Now, with life expectancy tables fixed, the annuitization method always yields an annual distribution which is just slightly less than the amortization method. As a result, this author can think of no reason to use the annuitization method. Instead, the amortization method is always preferable and there are other tactics that can be employed if reducing the annual distribution is an objective.

Further, the annuitization is packed with some not so easy to understand higher mathematics. Rather than waste space here, if one is really interested in annuitization modeling, please visit any of several other websites that have built annuitization calculators.

MODEL VALIDATION

At the beginning, it was suggested that readers tread carefully when using Internet calculators for the amortization and annuitization methods. At the moment, 72(t) land is a bit uncertain again and one never knows which calculators have been updated for what. Nonetheless, these are pretty important tools to have for planning out big pieces of one's revenue budget for the next 5 to 10 years.

Solution. Assume John has the same $1,000,000 and he remained 52 for all of 2022. Further, assume interest rates of zero, 2.5% and 5.0%. The correct mathematical results are:

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76 "Aggressive" in the sense that more people die earlier; thus, the annuitant divisor computed from that mortality table is smaller thus resulting in a higher annual distribution.

	0.0%	2.5%	5.0%
Required Minimum Method			
Singe Life	$29,155	N/A	N/A
Joint & Several Life	$24,155	N/A	N/A
Uniform Life	$21,505	N/A	N/A
Fixed Amortization			
Single Life	$29,155	$43,761	$61,545
Joint & Several Life	$24,155	$39,049	$57,648
Uniform Life	$21,505	$36,614	$55,769
Fixed Annuitization			
Single Life	$28,689	$43,521	$60,617

These results are accurate to $1. Use any online calculator you like — almost all are free. Just throw in a few test cases from above. If you get the same answer, you're good. If you get a different answer, you had best leave for some place more reliable. Two calculators that the author knows are correct are located at: www.72tnet.com and www.72tcalc.com.

CHAPTER 4 - ACCOUNT ISSUES & METHOD CHANGES

Up until October, 2002, everyone in the tax community was rightfully concerned that prematurely exhausting one's IRA account exposed oneself to the retroactive imposition of the 10% surtax plus interest. No longer. Revenue Ruling 2002-62 (and now Notice 2022-6) did bring some welcome relief to taxpayers who had launched SEPP programs in the 90's and were now facing some dire circumstances of early and over-depleted IRA assets. Now, taxpayers have some SEPP plan exit strategies that avoid 100% of the surtax and related interest charges.

BEGINNING ACCOUNT BALANCES

One of the most frequent questions raised is what beginning account balance(s) to use for documenting the commencement of a SEPP plan. Remembering that taxpayers interact differently with their trustee / custodian in 2022 versus twenty years ago, Notice 2022-6 gives us a new rule:

> *"(d) Account balance. For purposes of applying the required minimum distribution method, the account balance for a distribution year is determined under §1.401(a)(9)-5. For the fixed amortization method and fixed annuitization methods, the account balance must be determined in a reasonable manner based on the facts and circumstances. The account balance will be treated as determined in a reasonable manner if it is the account balance on any date within the period that begins on December 31st of the year prior to the date of the first distribution and ends on the date of the fist distribution."*
>
> *Notice 2022-6*

What does the above really say? We really have a "calendar accordion". Its shortest is 1 day; its longest is 365 days. What we really need first is the date of the 1st distribution; let's assume 4/1/2022. The above says to create a time window commencing on 12/31/2021 and ending on 3/31/2022. Show me a piece of paper that has the account balance printed on it and is dated "as of" any date between and including 12/31/2021 and 3/31/2022 and you are good to go.

What is more critical here is the concept of evidence. You know how old you are and have a drivers license (the evidence) to prove it. You also know what the correct interest rate maximum is; its either 5% or a mid-term applicable federal rate we can look up (also evidence). What is your beginning account balance? Writing it down is insufficient. Print it out, save the monthly report you get in the mail, take a screen shot — whatever; the bottom line is to create a document that is incontrovertible external evidence — make 4 copies so you can loose 3 and gold plate number 4.

ACCOUNT EXHAUSTION

Notice 2022-6 says in part:

> *"(a) Complete depletion of assets. If, as a result of following a method of determining substantially equal periodic payments that qualifies for the exception of §72(t)(2)(A)(iv), an individual's assets in an individual account plan or an IRA are exhausted, any resulting reduction in the amount of the final payment (and the subsequeny cessation of payments) is not a modification within the meaning of §72(t)(4). Accordingly, the recapture tax described in §72(t)(4) will not apply in this case"*
>
> *Notice 2022-6*

What does the above really say? It says that no matter when you run out of money in your IRA and therefore stop distributions, no penalties or interest will apply. This is extremely good news; but for the obvious, which is that your IRA has run out of money. However, there are some rules which must be followed:

- The SEPP plan which you are currently following, presumably designed some years past, was, at that time, an "acceptable method". How do you know if your method / plan was acceptable? Hopefully, you documented your plan specifics some years ago and may even have an opinion letter from a tax accountant, CPA or attorney. All of these are evidence of acceptable methods.

- The IRA account(s) from which SEPPs are being performed **MUST BE 100% EXHAUSTED**[77]. Notice the first word in the excerpt above: "complete". Less than 100% does not qualify. Therefore, to avail oneself of this option, make absolutely sure that all assets are distributed from the IRA, right down to the last penny. Leaving $1 or $123 in the IRA account would theoretically disallow this treatment, thus reimposing the 10% surtax and interest.

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[77] Recently, a "phoenix from the ashes" circumstance has been under study. What if a taxpayer exhausted their account in 2020 and further made a less than planned distribution in 2020 to cause the account balance at 12/31/2020 to be zero? However, to achieve that zero balance at 12/31/2020, the IRA trustee valued a non-performing asset that remained in the account at zero and subsequently, say in 2024, that asset (maybe a bond in bankruptcy) starts to once again perform; starts paying again; receives liquidation proceeds, etc. Did the IRA really have a zero balance at 12/31/2020? Was the IRA completely exhausted? The answer is we do not know. There have been no rulings or other pronouncements from the IRS to help us in creating standards to test this situation. As a result, this then represents a situation to potentially be avoided for taxpayers planning on the launch of SEPP plans.

METHOD CHANGES

As a general rule, all method changes are considered "modifications" thus imposing the 10% surtax plus interest. However, Notice 2022-6 provides a "one time escape" mechanism for taxpayers who have an existing SEPP plan and want to materially modify their annual distributions going forward.

> *"(b) One-time change from the fixed amortization method or fixed annuitization method to required minimum distribution method. An individual who begins distributions using either the fixed amortization method or the fixed annuitization method is permitted in any subsequent distribution year to switch to the required minimum distribution method to determine the payment for the distribution year of the switch and all subsequent distribution years, and this change in method will not be treated as a modification within the meaning of §72(t)(4). Once a change is made under this paragraph, any subsequent change from the required minimum distribution will be a modification for purposes of §72(t)(4)."*
>
> *Notice 2022-6*

An individual who began distributions using either the fixed amortization or fixed annuity method may switch to the "required minimum distribution" (RMD) method and the change in method will not be considered a modification; thus no penalties or interest. This represents a terrific planning opportunity in that it is open ended and need not be exercised within any specific time frame; however, once elected, it is "cast in stone", e.g. taxpayers only get to make this election once and then must stick with it. Again, some observations:

Remember John, aged 52 with a $1,000,000 IRA. He started using the fixed amortization method distributing $60,617 per year. Fast forward to 2026 when he is 56. His alternatives become:

- Do nothing and continue distributing $60,617.
- Switch to the required minimum method. Assuming his IRA balance is still $1,000,000:
  - Using the single life table; distribute $32,680.
  - Using the joint & several life table; distribute $26,667.
  - Using the uniform life table; distribute $23, 474.

What if John has been a very astute investor resulting in a 12/31/2025 balance of $4,000,000. All of the numbers immediately above quadruple.

Next, care should be taken when invoking this method change. It must be done for the entire year in which the taxpayer elects and all future years as well. Mid-year method changes are not allowed, e.g. distributing using amortization for ½ year and then distributing using the minimum method for the second ½ of year is not allowed. However, a bit counter-intuitively, a taxpayer might make the method switch mental decision at mid-year and has just implicitly elected to make that method conversion 180 days previous on January 1st of that year. Care then needs to be taken to not be over distributed by the sum of distributions already made previously within the calendar year.

Lastly, plan documentation is always critical and is discussed in more detail a little later. Within the context of a method change election, written documentation is absolutely critical. Envision John making 3 or 4 annual distributions of $60,000 each followed by a $36,000 distribution in year 5 because he elected the method switch. There is no reporting mechanism of a method switch to the IRS. Any IRS computer worth its salt will scream MODIFICATION! Be prepared in advance to respond to that letter.

CHAPTER 5 - OTHER PLANNING ISSUES

Someone once said success or winning is in the details. In this author's opinion, no truer words could be spoken regarding the planning of SEPPs. Thus far we have covered a lot of ground discussing all of the relevant authorities and general concepts as well as the computational specifics of all three methods. Now, we need to put all this together to effectively plan a SEPP program. But, before we can do that, there are a variety of tactical planning topics that require some coverage. What follows are planning tips. Sometimes these tips are obvious and simply need repeating within the context of a SEPP. Usually, these tips are founded in other sections of the IRC or related documents of authority. Other times, these planning tips are the author's opinion combining established authority and patterns in the PLRs with in-depth experience on the subject.

HOW TO PLAN A SEPP

This author's opinion is that SEPPs should be planned in reverse. Step one should be to quickly use the amortization method with a maximum allowable interest rate based on the sum of your IRA balances to arrive at a theoretical maximum annual distribution. This a quick "back-of-the-envelope" calculation to determine a reasonable upper limit. Using John again, age 52, with $1,000,000 in IRAs and an interest rate assumption of 5% we can quickly learn that his theoretical maximum annual distribution approximates $60,000 per annum. John may have already decided that he needs $75,000 to $80,000 per year for the next eight years. John should stop right here and reassess his living needs or delay program implementation.

As a second example, let's assume John has decided that he needs $45,000 per year for the first four years and $60,000 per year for years five through eight (the increase attributable to John Jr.'s college tuition). Now we have something to work with --- a set of cash flow expectations that are under the upper limit. For the moment, let's forget about methods, interest rate ceilings and so forth. Instead, John should put all his energies into mapping out his detailed cash flow needs in as much detail as possible. This implies some budgeting for both regular living needs as well as planned capital expenditures, maybe tuition or elder care, as well as some kind of emergency fund.

Once we have future cash flows figured out, planning SEPPs is really rather easy. Whenever possible, we make the SEPPs fit the cash flow needs, not the other way around. What follows are simply a set of tactical formation tools that will allow you to custom tailor a SEPP program or series of SEPP programs to fit your needs.

ACCOUNT FRACTURING & AGGREGATION

All of our previous examples have focused on a single IRA with a single balance. This is fine for example purposes, but poorly reflects real life. More often than not, a taxpayer will have a whole collection of deferred accounts with wide-ranging values. The IRC is very clear on the subject of account fracturing (one into many) and account aggregation (many into one). As long as the IRAs are moving between or within approved trustees, anything is game before the actual commencement of a SEPP plan. John can have four IRAs or forty (by fracturing) or twenty-one by combining the last twenty into one (through aggregation). Thus, how do we interpret and use these rules in light of our desire to create one or more SEPP programs?

- First, all account fracturing[78] or aggregation relative to the IRA accounts to be used for the SEPP program must be completed before the first SEPP withdrawal is made. This effectively defines the IRA account universe from which SEPPs will be performed.

- Second, once the first SEPP distribution has occurred, the account universe (which can be one or several deferred accounts) is cast in concrete for the duration of the SEPP program. Accounts within the universe must stay inside the universe & can not leave. Similarly, accounts outside the universe can not enter. Another way to think about this is that the only cash transactions permitted within the account universe are the periodic withdrawal transactions. To add an account after the first withdrawal transaction effectively looks like account replenishment which is specifically prohibited[79]; to remove an account almost looks like a withdrawal of sorts and thus a modification.

- Third, and conveniently, any fracturing or aggregation of other non-SEPP IRA accounts can be left for a future date.

- Fourth, and potentially the most important, one must strike a balance between committing assets to the account universe in order to receive the SEPP distributions versus holding some IRA account assets outside the account universe (housed in separate IRAs) for future needs and/or risk exposure.

- As a practical matter, unless there is a specific requirement to the contrary, we recommend against creating a SEPP universe. Better to simply aggregate all IRAs into one that are going to be part of the plan before the 1st distribution.

MULTIPLE SEPP PROGRAMS[80]

Why not? An excellent tactical move for John is commence SEPP program #1 immediately to provide his base needs of $45,000 per year and commence SEPP program #2 four years in the future to cover the college tuition payments. What are the rules to make this work effectively?

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78 In one of the few adverse PLRs, in 97-05033, the IRS: "the entire account balance in each of the pertinent IRAs must be taken into account. That is, a portion of one or more of the IRAs may not be excluded in order to limit the periodic payment to a predetermined amount." The ruling itself is very clear. What is unclear is whether the taxpayer had intended to fracture one of his IRAs before commencing his SEPPs and simply neglected to do so, or whether his independent advisor simply made an interpretive or mathematical error. Nonetheless, the ruling is very clear; get all of your account fracturing done before the first withdrawal.

79 See Revenue Ruling 2002-62, .02(e)(I).

80 See PLR 98-12038.

- The IRA accounts for program #1 and program #2 must be discrete; meaning that they may not overlap, and must remain so for the duration of the SEPP programs.

- SEPP withdrawal dollars for program #1 must be withdrawn from IRA #1 and similarly SEPP withdrawal dollars for program #2 must be withdrawn from IRA #2. Cash transactions which cross between the IRAs are not permitted and would have the effect of causing a modification to both SEPP programs.

- SEPP program #1 and program #2 are completely independent of each other. Thus, as an example, program #1 can start using the amortization method using 5% at age 52 and program #2 can commence four years later using the RMD method.

IMPORTANT DATES

There are a variety of calendar dates that are important: your birthday; your SEPP starting date, as defined by the date of the first cash distribution; and account valuation dates. Each of these dates are important for different reasons. Further, these dates actually have little relative importance in computing the dollar amount of SEPPs, but they are all administratively critical; e.g. date errors are easy to make and have a small, but real, possibility of invalidating a SEPP program.

Unless otherwise specifically noted, IRC §§401-424 and §72 always use the concept of "highest attained age within a tax year". As an example, if your birthday is 6/30/50 and today is 6/29/00, we all know that you are 49 and one day later you will be 50. However, should you commence a SEPP program anytime in 2000, you are considered to be 50 for program design purposes as 50 is your highest attained age within the tax year 2000.

SEPP programs must continue for a minimum of five years. When do we start counting and how do we count? A SEPP program's start date is the calendar date of the first withdrawal transaction from one or more of the accounts defined in the SEPP universe. From that date, we literally add 1828 days.[81] 1828 is 365 times 5 plus the potential for two leap years; plus one day for insurance. Alternatively, if the first SEPP distribution occurred on 3/15/00; then the ending date for the SEPP program becomes 3/15/05. As a result, during the intervening five years, the only allowable cash transactions are those which are the SEPP distributions[82].

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81 Remember the Arnold v. Commissioner case (111 TC 250; 1998 U. S. Tax Ct.). In this case, the Court sided with the IRS in a literal interpretation of the IRC that five years was indeed the effective equivalent of 1828 days. Although it has never been litigated, the same question would apply to determining when a taxpayer turns 59 ½. Because we are discussing the interpretation of the IRC and not some IRS announcement of some kind, it is the author's opinion that the safest interpretation is a literal one: adding 183 days to one's 59th birthday.

82 As a result of this, it becomes very prudent for a taxpayer to consider fracturing their IRA before commencing SEPPs into two IRAs: A & B, fully intending to only make SEPP distributions from IRA A. Then should an unforeseen event occur requiring a quick infusion of cash; that unforeseen emergency can be handled from IRA B. As a result, regular income taxes and the 10% penalty would be due on the distributions from IRA B. Not necessarily the most desirable event in the

Accounts can technically be valued on any date, However, as an administrative matter of proving up a valuation, this author always suggests that month-ends be used. A document prepared by an external body, e.g. your brokerage firm is always nice to have in your files should anyone ever ask how you arrived at a dollar valuation for an account.

SEPPs, in addition to running for five full years, must also continue until you attain your 59 ½ birthday. Not surprisingly, you attain your 59 ½ birthday exactly 183 days after your 59th birthday.

In order to completely satisfy the §72(t) rules, SEPPs must continue for at least five full years and until you attain the age of 59 ½. You will know your SEPP start date --- write it down. You can easily compute the SEPP start date plus five full years as well as compute your 59 ½ birthday. Use the later of these two dates and discard the earlier. When executing transactions in your IRA, simply insure that the only cash transactions are the SEPP transactions between these two dates.

Conveniently, www.72tnet.com has a "First Modification Date Calculator" which will provide the same results.

DISBURSEMENT FREQUENCIES & LOCATIONS

We can define the account universe (implying two or more physical accounts) from which the cash distributions will be made in order to satisfy the SEPP program. Let's assume two accounts for the moment, but it could just as easily be ten accounts. When you decide to make a SEPP disbursement, that disbursement can come from any one or more than one account that was originally defined as a member of the account universe. As an example, if the universe is comprised of two accounts and you wish to make a withdrawal of $10,000, you may withdraw the $10,000 all from account #1, $10,000 all from account #2, $2,500 from account #1 and $7,500 from account #2, or any other permutation of dollars between the accounts that suit your needs.

IRC §72(t)(2)(A)(iv) says in part: "(not less frequently than annually)". This creates a one-sided test of once a year. Further, there is no definitive guidance[83] suggesting any tests on the other side. Accordingly, multiple disbursements are just fine, be they equal or unequal in time or amount. What is critical is that the sum of the distributions made within a calendar year do, in fact, add up to the correct annual amount[84]. As a result, a word of caution is appropriate here. Events always seem to get a little

world but better to pay the penalty on IRA B distributions alone than to pay the penalties on all the distributions made from IRA A as well.

83 Actually, this is not entirely true. There are several dozen PLRs all granting the taxpayer the ability to vary the frequency of the distributions made on an intra-year basis. However, invariably, the essence of the PLR was focused elsewhere than on distribution frequency.

84 IRC §408(d)(2)(B) says: "all distributions during any taxable year shall be treated as one distribution." As a result, intra-year distribution locations and frequency are entirely at the discretion of the taxpayer.

hectic around year-ends, sometimes a December 29th transaction does not get processed until January 2nd or vice-versa. If this happens to be your final or first SEPP transaction of the year (or next year) and it is inadvertently mis-processed into the wrong year --- guess what --- you're responsible. At a minimum, this situation is going to take some time, persuasion and corrected documents to fix. At a maximum, it is going to look like a program modification. Thus a word of caution; simply avoid the period December 20th through January 10th of the year & transact your business using any one of the other 345 days of the year.

DE MINIMIS ISSUES

"De minimis" equals small or insignificant on either a relative or absolute scale. What is de minimis to the Internal Revenue Service? One dollar. The IRS permits rounding or truncation of pennies on a tax return, but you do not get to round to the nearest $10 or $100. This concept comes into play in two circumstances; calculations and cash transactions.

- Calculation --- John, aged 52 with $1,000,000 in his IRA chooses the minimum method. The calculation is $1,000,000 / 34.3, which equals exactly $29,154.52. Therefore, both $29,154 and $29,155 are equally acceptable representing penny dropping and rounding respectively. $29,150 and 29,160 are not acceptable.

- Cash Transactions --- John needs to withdraw $29,155 and does so by instructing his IRA trustee to distribute exactly $2,429.58 every month through automatic transfer between his IRA and his checking account. This results in $29,154.96 in annual distributions; $0.44 different than the calculation. This difference will be considered de minimus. If John were to err and instruct his trustee to transfer $2,430 every month; thus totaling $29,160.00 it would create a difference of $4.52; an amount that would not be considered de minimus.

Any non-de minimus difference has the potential to be treated as a modification resulting in the imposition of the 10% surtax. In this author's opinion, if John missed by $3 or even $10, the IRS would most likely not call it a modification. However, why take the chance particularly when there is nothing but down-side risk. Calculate, recalculate, and stick to the correct amounts within one dollar.

COST OF LIVING ADJUSTMENTS

The required minimum distribution method has a built-in cost-of-living adjustment, (COLA) of sorts. Each year, the RMD method requires using an updated account balance (hopefully higher than last year's) and using your new age (hopefully only one year older) which in turn creates a smaller divisor from one of the three life expectancy tables you chose to use. This, but for decreased account balances from year-to-year, will automatically result in an increased distribution in all subsequent years. The precise differences change with age, but the single life table will automatically produce a 2½% to 3½% increase annually as one progresses from their 40's through their 60's.

Conversely, the amortization and annuitization methods are usually one-time, one amount determinations. They do not have built-in COLA features. Pre-1/1/03, COLAed SEPP plans were common. Through a variety of private letter rulings[85], the IRS had determined that adding a cost-of-living increase to the fixed amounts determined under the amortization and annuitization methods did represent "substantially equal". The language in Rev. Rule 2002-62 and Notice 2022-6 seem to preclude this type of plan going forward.

As a final footnote on this subject, the Joint Committee on Taxation said: "A series of payments under a defined contribution or defined benefit plan WILL NOT FAIL to be substantially equal because the payments vary on account of: (1) certain cost of living adjustments...The committee intends that the Secretary may prescribe regulations setting forth other factors...that will not cause payments to fail to be considered substantially equal." This would imply, remembering that these notes come from the JCT work on the Tax Reform Act of 1986 and are therefore of fairly high precedential value, that Congress clearly intended that "substantially equal" and "equal" are very different. Further, that COLAs were contemplated within the definition of "substantially equal". However, as mentioned previously, no one, since the issuance of Revenue Ruling 2002-62 has been willing to step up to plate and file for a PLR on this subject.

ANNUAL RECALCULATION OF THE AMORTIZATION & ANNUITIZATION METHODS

If there is a hot issue for 2022 and forward; this is it. This subject received a lot of attention in the late 1990's resulting in more than ½ dozen private letter rulings approving various methodologies for annual recalculation. Finally, in the summer of 2000, the IRS issued an information letter[86]. In part, this letter said:

> *"If payments are recalculated each year using the [amortization or annuitization] method, then payments would be recalculated in the same manner, using the account balance as of the same day each year, the applicable life expectancy (or life expectancies), and the same interest rate "standard" in effect for the same period of the year, which must provide an interest rate that does not exceed a reasonable interest rate on the date payments commence."*
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> *IRS Information Letter, circa 2000*

An Information Letter, as defined in Revenue Ruling 2000-4, "calls attention to a well established interpretation or principal of tax law...without applying it to a specific set of facts...An

85 See PLRs 90-47043, 95-36031, 97-26035 and 98-16028.

86 The following is an excerpt from an Information Letter received by the author from the IRS; more specifically, the Manager of Employee Plans Actuarial Group II, Tax Exempt & Government Entities Division of the Assistant General Counsel's Office.

information letter is advisory only and has no binding effect on the IRS[87]." As a result, we can rely upon an Information Letter from a theory perspective only and must carefully apply that theory to each individual taxpayer's unique fact set.

However, in the Fall of 2002, the Service issued Revenue Ruling 2002-62[88] which says in part:

> *"(b) The fixed amortization method. The annual payment[s]...are determined once for the first distribution year and the annual payment is the same amount in each succeeding year."*
>
> *Revenue Ruling 2002-62, Section 2, .01 (b)*

The language above is similarly repeated for the annuitization method. In short, Revenue Ruling 2002-62 used the term "fixed" numerous times such that one could only come to the conclusion that the ruling specifically intended to take away the "annual recalculation" concept. Or did it? Several petitioners have pointed out, via private letter ruling requests, two related principles:

(1) Revenue Ruling 2002-62 was written in a "safe harbor" manner, e.g. follow all the detailed rules in the ruling and one's distribution plan will be automatically considered safe or approved, irrespective of the actual mathematical result. The converse is that distribution plans that do not follow all of the rules are not automatically disqualified, rather they are simply in "no man's land" and are neither approved or disapproved.

(2) The required minimum distribution method does require annual recalculation saying in part, "annual payments are redetermined for each year." Additionally, the required minimum distribution method is the same, or is at least calculated the in the same manner, as the amortization method simply assuming an interest rate of zero.

These two arguments formed the basis for several private letter ruling requests asking the Service to formally re-institute annual recalculation for the amortization and annuitization methods. Fortunately, the Service concurred. In the approved private letter ruling[89], the operative language was:

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87 As usual, the Service gets a little carried away (or cautious) with their language here. An Information Letter is binding and it is precedent setting; but only from a theory perspective. It does therefore leave open the question of did a taxpayer properly interpret and apply the theory correctly to his or her own specific facts & circumstances.

88 In this case Revenue Ruling 2002-62 was issued subsequent to the Information Letter & should further be considered a higher authority than an Information Letter. Therefore, the revenue ruling "trumps" the information letter to the extent applicable.

89 This language is a direct transcription of a private letter ruling issued in June, 2004. Also see PLRs 2004-32023 and 2004-32024.

> *Taxpayer A proposes to determine the annual payment...using the fixed amortization method as described in Revenue Ruling 2002-62, except that rather than making a fixed annual payment, Taxpayer A proposes to recalculate the amount of the annual payment...For subsequent years, Taxpayer A will recalculate the annual distribution for each succeeding year based on the account balance of the IRA as of December 31st of the prior year, determine his life expectancy as of his age in each subsequent year using the single life table... and 120 percent of the federal mid-term rate as of December 31st of the prior year.*
>
> *PLR 2004-32021*

So how do we reconcile all of the "fixed" language found in Revenue Ruling 2002-62 versus the approved PLR language above? Fortunately, we don't have to. In the Fall of 2002, the Service issued FAQs Regarding Revenue Ruling 2002-62. This document containing seventeen different questions and Service answers to help taxpayers interpret the provisions of Revenue Ruling 2002-62. Of particular note is Q&A 17:

> "(17) Are the [computational] methods contained in Rev. Rule 2002-62 the only acceptable methods of meeting section 72(t)(2)(A)(iv) of the Code?
>
> No. Another method may be used in a private letter ruling request, but, of course, it would be subject to individual analysis."

This effectively became an open invitation to taxpayers for the submission of new methods not currently found in Revenue Ruling 2002-62. Although the operative language in the recently approved private letter ruling does not explicitly say so, this PLR effectively create a new method #4, outside the boundaries of the Ruling, making annual recalculation with the amortization[90] concept an approved method[91]. During the period 2003 through 2006, the IRS issued no less than nine new PLRs all of which

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90 This private letter ruling request focused on the annual recalculation and the amortization method skipping any reference to the annuitization method; therefore, in a strict sense we can only say that annual recalculation is now (re) approved for amortization computations, not annuitization computations. Nonetheless, we don't care. As previously discussed, the annuitization method always produces a lower annual distribution amount than the amortization method, therefore we would always select the amortization method for individual use, with or without annual recalculation, and use other techniques to reduce the annual distribution amount if so desired.

91 As an intellectual aside, IRC §72(t)(4); that's the code section that invokes the 10% surtax retroactively, says "the series of payments...are subsequently modified" really should apply. The annual recalculation process does cause the payments to be modified; however, the IRS has graciously interpreted this to mean that as long as the plan remains unmodified, §72(t)(4) does not apply even though the payments themselves have changed. As the old saying goes, as long as the interpretation is in our favor, we do not look a gift horse in the mouth.

were affirmative on the issue of annual recalculation.

So, now that annual recalculation is back on the approved list, why would we do it and how would we do it? Let's tackle the why first by focusing a little more closely on how the amortization formula works. The amortization formula uses three variables: principal amount, life expectancy and interest rate; however, not all three variable are equal in manner in which they effect annual distribution outcomes:

(1) As the principal amount increases (or decreases), the annual distribution amount changes in an linear fashion; e.g. if the principal amount goes up by 15%, the annual distribution amount also goes up by exactly 15%.

(2) As a taxpayer ages by one year, his or her life expectancy drops, usually by .9 years, resulting in a 1.5% to 2.5% increase in the annual distribution amount.

(3) As interest rates change so does the distribution amount, but not linearly. A 25% change in the interest rate; e.g. from 4% to 5% only results in a 10.8% increase in the distribution amount; approximately a 2.5:1 relationship.

However, put all the changes together: principal up 15%, one year older and interest rate up 25% and the resultant annual distribution goes up by 30%; just a little more than the additive effect of the individual factors would suggest. Bottom line, most to all of the action is in the change in the principal balance and the effect of aging and interest rate change are minor in comparison. With this in mind, how might a taxpayer successfully and effectively implement annual recalculation?

With the fixed amortization method, the outcomes are known; e.g. a 55 year old with $1,000,000 using a 4% interest rate will distribute $56,304 per year for the next five years. The only unknown in this situation is the ending IRA balance five years in the future which will be predominately determined by investment experience less the aggregate of the annual distributions of $281,520.

With annual recalculation, the future annual distributions become variable and unknown. Another word for "unknown" is risk! So, at least initially, we should consider annual recalculation as "riskier" than the fixed computation. In this regard, there are several types of risk both downside and upside:

(1) Taxpayer living expenses tend to be mixed; e.g. some are fixed and some are variable. Mortgages, the utility bills, food look more like fixed expenses. Vacations, cars, medical expenses tend to look like variable expenses. What if the a future period annually recalculated distribution comes up with a number that is less than the taxpayer's annual fixed expenses? Not a good place to be unless other resources are available to take up the slack.

(2) On the upside, what if a future period annually recalculated distribution comes up with a materially larger number than needed potentially causing a jump upward in federal and state tax brackets causing too much tax to be paid too early? Not exactly the worst situation in the world, but one to be avoided if possible.

A way to mitigate these risks is to adopt multiple SEPP plans. As ususal, assume John, aged 55 has a $1,000,000 IRA and has thoroughly analyzed his family living expenses and has categorized them as $40,000 fixed and $20,000 variable. Lastly, the current applicable interest rate is 5%. John has three fundamental choices:

(1) Adopt one fixed amortization plan distributing $63,613 per year. Better yet, John should split his IRA into two IRAs of $940,000 and $60,000 distributing $59,800 from IRA #1 and holding IRA #2 on side for unplanned emergencies.

(2) Adopt one annually recalculated amortization plan distributing $63,613 in year one. By year three:

    (A) John's IRA is worth $1,600,000, interest rates are still at 5% and John is 58 resulting in a distribution of $105,838.

    (B) John's IRA is worth $500,000, interest rates are now at 5% and John is still 58 resulting in a distribution of $33,075; well below his fixed annual living expenses.

    Both of the outcomes above are undesirable. In 2(A) John is forced to distribute funds he does not need and will likely jump a tax bracket or two paying more marginally higher federal and state taxes than he should. In 2(B), John, unless he has other non-IRA related financial resources to fill in the cash flow shortfall, is bankrupt to the extent that he will be forced into some untimely and likely unpleasant life style changes.

(3) Adopt two amortization plans; plan one is fixed using IRA #1 with a balance of $630,000 yielding $40,076 per year in distributions; very closely matched to John's annual fixed living expenses; plan two is annually recalculated using IRA #2 with a balance of $370,000 yielding a distribution of $23,540, at least for the first year. Let's re-apply the same year three outcomes:

    (A) John's IRAs are now worth $1,600,000 ($1,008,000 in IRA #1 and $592,000 in IRA #2). Interest rates are at 5% and John is now 58. Because plan #1 was fixed, $40,076 is still distributed. Plan #2 is variable and therefore $39,160 distributed for a total of $79,236; maybe more than John wanted to distribute, but still a fairly nice "in between" number; higher than the $63,600 in (1) above, but whole lot less than the $105,838 in (2) above.

    (B) John's IRAs are now worth $500,000 ($315,000 in IRA #1 and $185,000 in IRA #2). Similarly, interest rates are at 5% and John is now 58. Again, $40,076 is distributed from plan #1. Plan #2 is recalculated and the distribution is $12,238 for a total of $52,314; an aggregate distribution that is smaller than John would like, but certainly a livable number that does not force a drastic lifestyle change at exactly the wrong time.

The above are needless-to-say, simplistic examples of potential outcomes and every taxpayer's circumstances are going to be different. Accordingly, taxpayer's should think and model their way through this issue very carefully. Several additional points are worth consideration:

(1) Bob, John's brother says to himself: "I would never, ever invest so imprudently as to let my IRA balance fall by 50% over three years!" We know lots of Bob's and we get phone calls and emails from them weekly. Further, remember that Bob or John's IRA is getting hit twice each year; roughly a \$60,000 annual cash distribution as well as the depreciation in the marketable securities in the account. As a result, it only takes a 35% decrease in value to actually halve the aggregate value of the account; approximately 10% per year compounded.

(2) John retains the ability to perform a one time method switch to the RMD method[92]. As a result, let's compare the upside outcomes of scenarios (2) and (3). In (2), John was forced to distribute \$133,480; no other options are available. In (3), John has two options: (a) distribute \$79,236; (b) switch plan #1 from the fixed amortization method to the RMD method resulting in a distribution of \$34,878 plus the \$39,160 from plan #2 totaling \$74,040; not a whole lot less than the \$79,236; but still materially less than the \$105,838 distribution required in (2).

In summary, bifurcating[93] the IRAs in advance represents a valuable planning tool that can be used to retain distribution flexibility for future years. The retention of the flexibility becomes insurance against the risks associated with adopting annually recalculated plans while retaining what are hopefully the "upside" benefits.

Now that we know how to effectively plan the use of an annually recalculated plan, how do we tactically implement correctly? Fortunately, the operative language in the PLRs is essentially the same as found in the Information Letter of 2000. In this regard:

(1) All three variables must be updated[94] simultaneously when recalculating.

(2) All three variables must be updated as of the same day each year. Theoretically, any day of the year is an acceptable day; however, month-ends, quarter-ends and year-ends are recommended as this may be the only time that external evidence is available to "prove up" an IRA balance.

(3) No methodology changes are permitted; simply a substitution of new values and the resultant computation.

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92 The one-time change to the RMD method is only permitted with respect to the fixed amortization and annuitization methods, not the annually recalculated methods.

93 Actually, the author recommends trifurating (if there is such a word) one's IRA into three IRAs; IRA #1 used to launch a fixed SEPP plan, IRA #2 used to launch an annually recalculated plan, and IRA #3 held on the side for unplanned emergencies.

94 This is contrary to some of the rulings issued in the 1990's where taxpayers did receive some favorable rulings permitting the updating of just two of the three variables; most often updating the IRA balance and age but holding the interest rate constant.

So how might we implement this? Let's use John again with a $1,000,000 IRA, aged 55 and an interest rate assumption of 5%. Lastly, the date is July 1, 2004. The mathematics of the amortization formula dictate an initial annual distribution of $63,613[95]. Now, John has some options:

(1) Distribute the full $63,613 sometime between 7/1/04 and 12/31/04; or, chose to treat 2004 as a "stub-year" distributing a prorata amount for 2004 of $31,806 representing ½ of the year.

(2) John's first recalculation date need not be one year in the future and there is good reason for it not to be. John might decide to recalculate as of 12/31/04. Assume his 12/31/04 IRA balance is $1,100,000, the interest rate remains at 5.00% and he now 56 years old. Again the mathematics of the amortization formula dictate an annual distribution for 2005 of $70,940[96]. John has all of 2005 in which to distribute this amount in a single or the sum of multiple distributions. Going forward, John absolutely must recalculate as of December 31st for all future years in the plan.

John could also pick a different recalculation date; e.g. 6/30/05. However, there are advantages and disadvantages in doing so:

(A) Delaying the recalculation date a full year (as opposed to six months) provides more time for the corpus of the IRA to grow; thus, all else being equal, delaying would more often than not provide a higher annual distribution.

(B) Distributions in advance of the computation are not permitted; they are also a bit illogical. Therefore, John can not distribute from the account during the period 1/1/05 to 6/30/05 but must instead wait, recalculate, then distribute.

(C) Related to (B) above, fiscal year computations, at one time allowed, are no longer. As an example, it would be nice to define a SEPP year as 7/1/04 to 6/30/05 with a required distribution of $63,613 during that time period. This makes imminent logical sense however, it grants a flexibility that can be materially abused by taxpayers; e.g. John could then manage his distributions across year-end boundaries, as he is a calendar year taxpayer, to artificially inflate/deflate recognized income between adjacent tax years. Thus, although a good idea, it is not permitted.

Finally, annual recalculation can get complex, particularly when multiple accounts and lives are being updated. To that end, this author strongly suggests that anyone planning on a SEPP program including annual recalculation should write themselves a contract. Amazingly, we all tend to forget the

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95 Using a spreadsheet command, this would be @pmt(1000000,.05,31.6).

96 Using a spreadsheet command, this would be @pmt(1100000,.05,30.6).

details over time[97]. In this situation, success is in the details. Here is some model language that can serve as a starting point:

YOUR NAME
LETTER OF SELF-DETERMINATION FOR
SUBSTANTIALLY EQUAL PERIODIC PAYMENTS
PURSUANT TO IRC §72(t)(2)(A)(iv)

I, [your name], have elected to commence substantially equal periodic payments pursuant to IRC §72(t)(2)(A)(iv). I am including the following list of IRA accounts: [list of accounts, locations, account numbers and balances] totaling [the aggregate balance] as of [the most recent month-end preceding the commencement of the SEPPs or other valuation date]. I am electing to use the [choose a method] distribution method as described in Notice 2022-6. My birth date is [your birth date]; therefore my highest attained age in 20XX [is / will be] [NN]. I have further elected to use the [single life table, uniform life table, joint & survivor table]. Lastly, I have elected to use an interest assumption of Q.QQQ%; this percentage equal to the higher of 120% of the mid-term applicable federal rate for the months of [list the months] immediately preceding my first distribution month of [insert month & year] or 5%. This in turn results in an annual distribution for 20XX of $XX,XXX.XX. I [am / am not] electing to treat 20XX as a [stub or full] year resulting in 20XX distributions of $XX,XXX.XX.

I intend to continue these substantially equal periodic payments commencing in [insert commencement month and year] and running uninterrupted to no less than [insert the month and year or actual date upon which you will attain the age of 59 ½ or the expiration 5 years] so as to avoid the reapplication of the 10% early withdrawal surtax as required under IRC §72(t)(1) & §72(t)(4)(A).

Lastly, I am adopting the [choose a method] method, as described above, on an annually recalculated basis. My annual recalculation date is [insert month & day] of each year commencing in 20XX and running through 20YY. On each of these dates, I will recalculate my annual distribution using updated IRA balance(s) as of that date, an updated maximum interest rate assumption equal to a percentage being equal to the higher of 120% of the mid-term applicable federal rate for the two months immediately preceding or 5%, and an updated life expectancy derived in the same manner as above using the [describe the life expectancy tables used].

The above should be signed, dated and copied twice. The original should go to your place of safekeeping; e.g. safety deposit box; copy #1 should go to your annual tax files; copy #2 should be sent as an attachment to whatever forms your trustee requires be completed in order to actually perform the distributions. The intent here is provide readers with the basics which should be included in a contract. Readers are free to modify and enhance the above templates to fit unique situations.

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97 Do you remember what you bought your significant other as a Christmas gift for 2020?

EVIDENCE

Those taxpayers that faithfully fill-out and mail in their warranty registration cards can skip this section; you all know what to save and where to put it. For the rest of us mortals, evidence is an important issue.

Every year, the IRS gets one piece of paper (albeit electronically) called a 1099R. The trustee of your deferred account is required by law to issue this document to you and the IRS every year identifying the distribution amounts you have taken in the preceding year. That's all the IRS gets. Further, to the best of our knowledge, there is absolutely no evidence (no pun intended) that taxpayers on SEPP plans are more or less likely to be audited. Conversely, there is a 100% likelihood that if you are audited and have a SEPP plan in place, that it will be scrutinized. As a result, audits do happen for a variety of reasons and SEPP planners need to be fully prepared if that event occurs. What do you need?

(1) Start with the "contract" or letter of determination. Complete it, date it, sign it & copy it. This is a summary document and will keep you, the taxpayer, on the straight and arrow path. However, it is self-created & thus is considered internal evidence. You will need external evidence as well.

(2) You chose an IRA or multiple IRAs or other deferred accounts. Please show me (this the IRS auditor talking) your December 31st (or other valuation date) account statements which you used to determine you beginning computational balance.

(3) You chose to commence distributions in April, 2004 using the amortization method and an interest rate of 4%. Please show me the 120% of mid-term applicable federal rates for February and March, 2004.

(4) You claim that you were 52 when you commenced distributions. Please show me your driver's license or a birth certificate.

(5) Oh, I see you adopted the amortization method using annual recalculation. Please show me all of the above for every year your SEPP plan has been in operation.

(6) Just to wrap up this part of the audit, please show me EVERY 1099R you have received since the beginning of your SEPP plan.

The author absolutely guarantees that if you are audited, all six of the above questions will be asked. You, the taxpayer, must be ready to produce and not having it is not an acceptable excuse. Also, please gather and safe keep these materials NOW. Don't wait until the 4th or 7th year and then panic when the audit notice arrives.

Enough said, you now know what to save & where to put it. While you're at it, fill out your product warranty cards and mail them in.

DEATH AND DIVORCE

Unfortunately, both death and divorce are part of life. How does the IRS treat these issues if SEPPs are currently in progress? If the taxpayer receiving the SEPP distributions dies[98], before attaining the age of 59 ½ or the passage of five years, then the SEPPs may cease and no penalties or interest are assessed. Further, if the SEPP recipient's spouse dies, the IRS has further ruled[99] that the surviving taxpayer can then recalculate future SEPPs using new methods and life expectancies. Thus, some flexibility is granted; however, the SEPPs must continue in some fashion.

If a taxpayer and his or her spouse divorce, the SEPPs, by default, stay with the taxpayer who was originally receiving them. But, what if the assets within the SEPP universe are split (let's say 50% and 50%) pursuant to a QDRO?[100] The IRS has ruled on numerous occasions that there are several solutions available as follows:

- For the original IRA owner & recipient of the SEPP withdrawals; he or she may:
    - Continue the existing SEPP distributions as if nothing has happened.
    - Continue the existing SEPP distributions on a proportionate or ratably reduced basis. For example, assume that the original SEPP program called for a $60,000 per annum distribution & the taxpayer has just transferred 50% of the IRA to his or her ex-spouse. Our taxpayer can continue post-divorce SEPPs at $30,000 per year.
- For the new IRA owner who has received what is essentially a new IRA from his or her ex-spouse; he or she may:
    - Do nothing at all.
    - Commence a new SEPP program completely independent and unrelated to the SEPP program that was in progress with the ex-spouse.
    - Voluntarily pick-up the remainderman $30,000 of SEPP distributions per year. In this last case, the history of the prior-year SEPPs would accrue to the new IRA owner; e.g. suppose that $60,000 per year had already been running for three years; then, the new IRA owner would "so to speak" receive three years of credit towards satisfying the five year rule. However, the new IRA owner's age (independent of the ex-spouse's age) would now govern in applying the 59 ½ test.

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98 See IRC §72(t)(2)(A)(ii).

99 See PLRs 89-19052 and 90-47076.

100 A "QDRO" is a qualified domestic relations order. The actual splitting of the IRA assets between spouses (or other family members) is a non-taxable transaction under IRC §414(p).

Thus, in the case of divorce there is some good news in that the IRS has granted several different planning opportunities. However, caution should be exercised here in that the transactions and elections should be carefully structured and documented.

SIMULTANEOUS PROCESSING WITH OTHER EXCEPTIONS

IRC §72(t) has been amended numerous times to the point where it now contains fourteen different exceptions ranging from the originals --- death and disability --- to a new group of exceptions for new home purchase, excessive medical expense and educational costs. How does the application of IRC §72(t)(2)(A)(iv) interact with the simultaneous application of other exceptions?

- Clearly, if you have two IRAs, A & B, and SEPPs are in progress using IRA A; any and all exceptions can be used on IRA B without fear of conflict. Given that financial emergencies are common, the astute taxpayer will design his or her SEPP program with a minimum of two IRAs, one for SEPPs and one as "dry powder" on the side to handle the unexpected.

- What about simultaneous processing of SEPPs and another exception on the same IRA? The concept of the frozen account universe for SEPPs and the only transaction permitted being the actual SEPP withdrawal would seem to argue against the processing of another exception transaction. On the other hand, there is no statutory provision prohibiting such an action. Therefore, why shouldn't a taxpayer be able to avail himself of such a transaction?

  As usual, the answer is unclear. Further, the IRS has never ruled on this particular issue; leaving us in virgin territory. As a result, this author would suggest the path of conservatism. Either don't attempt such a transaction or pursue a private letter ruling on the subject.

TAX PLANNING ISSUES FOR THE WEALTHY

Are you wealthy? You might not think so; however, if you are reading this text, you have a high likelihood of fitting Congress's definition of wealth. By definition, Congress tells us that the wealthy commence at $86,376 of taxable income (for single individuals) and $172,751 of taxable income (for married couples) for tax year 2021. This is taxable income, not adjusted gross income, so we can probably set gross income limits of $100,000 and $200,000 fairly easily. This then represents the practical floor, above which income will be taxed at 24% or more.

Conventional wisdom says that IRAs, 401(k)'s and the like are retirement vehicles that are typically off-limits until age 60 or so. Making a withdrawal to buy the Ferrari (or two trips around the world) is nothing but robbing from your own future. These are generalities that are most often true, but not always true. Let's return to John, age 52 who is still working and plans on continuing to work at a salary of $100,000 per year. Further, John is married with two teenagers, two cars, a mortgage and a front lawn to mow. As a result, John's taxable income, due to itemized deductions and four exemptions, is $65,000 per year; about mid-range in the 12% tax bracket. Further, John already has $2,000,000 in deferred assets.

Additionally, John can reasonably expect his $2 million to double in the next eight years and grow five-fold or more by the time he is seventy. Assuming $10 million at age 70, John's minimum required distribution will be $365,000 per year and it will only go up from there. In short, John will instantly be catapulted into the 32% tax bracket, or whatever else is the maximum tax bracket by then.

What should John do? Although it is a bit counter-intuitive, John should start SEPPs now, most likely in the range of $15,000 to $25,000 per year. In no way is it being suggested that John spend these distributions! Instead, we are suggesting that John convert $25,000 per year now from a deferred asset account (which will always be taxed as ordinary income when withdrawn) and pay 12% federal tax investing the net after-tax amount in a long-term conservative and capital gains oriented investment strategy or a ROTH IRA back-door conversion. Why? During the intervening years, be it 8 or 18, John will pay 12% tax on withdrawals from his IRA; conversely, if he waits[101] those same dollars will be taxed at 32% when withdrawn. Further, the early withdrawals can be re-invested in capital gain oriented investments with a maximum tax rate of 15% or 20%.

In short this is an exercise in tax bracket and tax method management. Most taxpayers, to their unwelcome surprise, are going to learn that their marginal tax bracket will not go down in retirement; for most their marginal tax bracket will, at best, stay the same and will likely rise. In these circumstances, several axioms come to mind:

- Always attempt, in this case through planned SEPP withdrawals, to recognize additional income in lower marginal tax bracket years.

- Always attempt to re-invest excess income in tax sheltered, tax free, dividend producing or capital gains taxed instruments.

The picture painted above is overly simplistic and most likely not reflective of your personal financial circumstance. However, were it to be true, notice that John does not have the luxury of waiting eight years to see the outcome. John needs to be looking at these issues right now, using some personal financial modeling and intuition about future events and outcomes. Everyone can do a quick computation of the big dollar issues in an hour or two using a spreadsheet or purchased financial planning software.

IMPROPER TRANSACTIONS

Usually, IRS regulations & rulings are lengthy (in both time to issue as well as pages), technically precise and confusing in the sense that one can get lost in the trees and not see the forest. Notice 2022-6 is the exception to the general rule. It provides some guidance on deferred account management and what the IRS will consider to be a modification remembering that a "modification" invokes IRC §72(t)(4) which in turn imposes the 10% surtax plus interest from the commencement of the substantially

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101 The IRS has borrowed some one's "auto repair" ad campaign in 90's that said: "You can pay me now or you can pay me a lot more later."

equal periodic payment stream. Thus, all taxpayers are desirous of avoiding the following:

> *(e) Changes to account balance. Under all three methods, substantially equal periodic payments are first calculated with respect to an account balance as of the first valuation date selected as described in section 3.02(d) of this notice. A modification to the series of payments will occur if, after such date, there is (1) any addition to the account balance other than by reason of investment experience, (2) any transfer of a portion of the account balance to another retirement plan, or (3) a rollover of the amount received by the employee.*
>
> *Notice 2022-6, .02(e)*

At first glance, the above seems to be pretty clear. Upon second glance it gets confusing. Upon third glance, it becomes downright contradictory. Upon fourth glance, no one is absolutely sure what it says. Further, there have been no subsequent rulings or other explanations to provide additional guidance on what this really means. As a result, we are in new territory and have to make some educated guesses as to the IRS's intent. However, there are two or three principles that can guide us in the following analysis:

(1) IRC §408(d)(3)(A) is commonly called the "rollover" rule. It statutorily grants every taxpayer the ability to distribute money from an IRA to themselves (thus initially creating a taxable event) and then subsequently redepositing those monies into an IRA within 60 days (thus erasing the taxable event). Further, taxpayers can elect to perform one rollover per calendar year. Thus, using the rollover rule, a taxpayer might withdraw $20,000 from their IRA to payoff a car loan; sell the car within 60 days and use the sale proceeds to put the $20,000 back in the IRA.

(2) Related to (1) above but technically very dissimilar are "trustee-to-trustee" transfers ("TTTT")[102]. TTTT's are not qualified under IRC §408(d)(3)(A) because technically they are not rollovers; instead they are, from inception, tax exempt transfers from trustee A to trustee B without intervention by the taxpayer. In this case, the taxpayer never has constructive receipt of the money (unlike (1) above) but would use this technique to move an IRA from an old full-service brokerage to a new discount brokerage.

(3) The IRS has explicitly identified three circumstances which they consider to be "modifications". However, some of the language in Notice 2022-6 seems to run in conflict with (1) and (2) above; or does it? This author would suggest a little creative language expansion to clarify the situation. When notice reads: "*a modification to the series of payments will occur if,*" might be better interpreted to read as: "a modification to the series

[102] See Revenue Ruling 78-406 (1978-2 C.B. 157).

of payments will occur if the taxability of the annual payment stream is altered as a result of:”.

With these concepts in mind, lets take a more detailed look at each of the three “modifications” identified by the IRS:

ACCOUNT REPLENISHMENT
(i) any addition to the account balance other than gains or losses,

A one point in time, multiple taxpayers filed for PLRs suggesting an account replishment scheme due to bad investment experience. All of the PLR requests were returned to the taxpayers but most likely lead to the drafting of new sections on: complete depletion of assets; and one-time change to the minimum method. It is these new sections that give taxpayers several other “outs” to either decrease or terminate their distributions thus making this technique of replishment rather moot.

TRANSFERS TO RETIREMENT PLANS
(ii) any nontaxable transfer of a portion of the account balance to another retirement plan,

Let’s remember that for purposes of IRC §72(t), we need to look at IRC §4974(c) for a definition of a “retirement plan”. In this case we find all the usual suspects: §401(a) plans; §403(b) plans and §401(k) plans. In addition, §408(a)’s are included; more commonly known as IRAs. Therefore a literal read of the above says an IRA-to-IRA rollover or a TTTT is no longer permitted! Not true. Congress has traditionally taken a pretty dim view whenever the IRS has attempted to overrule them as would seem to be the case here. However, we think the IRS is not attempting to overrule Congress; if anything, the IRS is simply guilty of some sloppy language. What the IRS was trying to say was a taxpayer can not use a rollover or TTTT to alter the taxability of the substantially equal periodic payment stream.

ROLLOVERS
(iii) a rollover of the amount received by the employee.

Well of course, the purpose of doing a rollover is so that it is not taxable. In this case, however, the IRS is talking about attempted rollovers of the distribution dollars as opposed to rolling over all or portion of the corpus of an IRA. Rollovers of required minimum distributions have long been disallowed pursuant to IRC §401(a)(9) & related regulations; otherwise everyone’s grandmother would make their RMDs and then immediately roll them over into an IRA thus perpetuating an IRA account forever. The same applies here.

PLANNING FOR FLEXIBILITY

If readers are going to read just one topic in Chapter 5 — THIS IS IT! If I am going have one SEPP plan, is two better? YES. I have two SEPP plans, is three better? MAYBE. I have three SEPP plans, is four better? DOUBTFUL. Three years from now some significant percentage of taxpayers who initiated SEPP plans three years previous are going to say: "My SEPP plan and my personal financial plan / circumstances are out-of-synch. What do I do now?" The answer is one needs to plan for flexibility before executing!

The greatest advantage of SEPP plans is that they exist as a method for early retirees to avoid the 10% surtax. Their greatest and overriding disadvantage is that they are rule bound and fundamentally fixed; once started they may not change. Unfortunately, life in general and one's financial life in particular tend to be fluid. Sounds like an "oil & water" situation and it is. However, there are several planning techniques that can be used to mitigate the risks associated with SEPP plans.

IRC §72(t)(2)(A)(iv) is always first applied on an account-by-account basis. Therefore, it is perfectly acceptable to have two or more IRA accounts, launching a SEPP plan on IRA #1 and doing nothing with IRA #2. This makes eminent good sense. This author calls it "dry powder on the side". Everyone, given enough time, experiences unexpected financial needs and emergencies. These needs can be downside, such as an unexpected and uninsured medical emergency; or they can be on the upside such as the desired purchase of a vacation home.

IF YOU HAVE ALL OF YOUR ASSETS TIED UP IN ONE IRA ACCOUNT, YOUR HANDS ARE TIED WITH RESPECT TO YOUR ABILITY TO HANDLE UNEXPECTED FINANCIAL NEEDS.

INVESTING IN REAL ESTATE

What does investing in real estate have to with SEPP plans? In a direct sense, absolutely nothing. In an indirect sense, a lot. Further, this question just seems to come a lot from taxpayers contemplating SEPP plans. As a result, it seemed prudent to at least touch on this subject.

IRC §408(m) is the only Code section that tells us what IRAs can not invest in[103]. In this case its focus is collectibles, e.g. works of art, rugs, antiques, metals, gems, stamps, coins, alcoholic beverages and other personal property as defined by the Commissioner. Noticeably absent from the list is real estate; therefore real estate investments are permitted to be made from IRA accounts. Our next stop is IRC Reg. 1.408-1(c) which contains very important provisions on:

(2) Prohibited transactions by the owner or beneficiary of the IRA.
(3) Prohibited transactions by a person other than the owner or beneficiary of the IRA.
(4) Pledging the account as security.

(2) and (3) above, to paraphrase the Regulations are the "prohibited transactions", "disqualified person" or sometimes called "self-dealing" regulations. For our purposes here a disqualified person[104] means the account owner and the beneficiary as well as all: spouses, ancestors, lineal descendants and any spouse of a lineal descendant; in short, everyone in your immediate family is considered a disqualified person. These same regulations tell us that any direct or implied transaction or transfer of benefit to or from the account between the account and a disqualified person is a "prohibited transaction". Further, a prohibited transaction is essentially treated the same as a distribution (therefore subject to regular income tax plus the §72(t) 10% surtax) plus a 100% surtax. Let's repeat that. An IRA that engages in a transaction with a disqualified person causes the transaction (let's say its worth $10,000) to become a disqualified transaction; therefore, regular income tax is due (let's say $2500); plus the surtax is due ($1000); plus the IRC §4975 prohibited transactions tax of $10,000. Total tax due: $13,500!!!

$13,500 is at least 11,000 reasons to absolutely never, ever (in)advertently get tangled up in a prohibited transaction. This makes real estate investing from an IRA very dangerous because some prohibited transactions are not necessarily obvious. Let's assume that you instruct your IRA to purchase a condominium on the beach and further, you instruct the management company to rent out your condo as part of their rental program. During the next five years, you:

(1) Stay in the condo for free (only paying a cleaning charge) one or two weeks per year.
(2) Bought new linens for the beds or hung a picture on the wall.
(3) Painted a wall or two.
(4) Invited your sister-in-law to stay for a week, no charge.
(5) Helped the condo management company by helping to collect some unpaid rent on your unit.
(6) Slipped up and paid the electric bill from your personal funds instead of the IRA paying it.

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103 In this case, the IRC defines impermissible investments as deemed distributions which has the same effect.

104 See IRC §4975(e)(2)(F) & (G).

(7) Supervised the remodeling of the kitchen.

Every one of these transactions is necessary, ordinary & normal for the condo at the beach. Every one of these transactions is a prohibited transaction. In every case, you are a disqualified person and in every case there is either an explicit or implicit transaction of some value occurring between the IRA an a disqualified person; therefore it is a prohibited transaction; therefore pay up!

So how does one directly invest in real estate yet avoid these prohibited transactions? You will need two helpers: a trust company and a management company. If you call up your friendly broker where ever your IRA is located and ask the broker to take title to the condo in your IRA, he will say no; he can not do it. Instead, you will need to seek out a trust company willing to accept your IRA and further willing to accept title of the condo in the IRA. These trust companies are actually rather easy to find. Just drive around town (usually the town where the condo is located) and start looking at the names of what you would think of as a bank. If their name is 1^{st} National Bank Of Condoland; then they are not a trust company. If their name is 2^{nd} State Bank & Trust Company of Condoland; then they are a trust company. It's the "& Trust Company" in the title that makes them a trust company, registered under the Trust Company Act and required to advertise as such. So now you have found a trust company who will take title of the condo for your IRA. Unfortunately, trust companies do not do this for free; they will charge a fee, anywhere from ½ % to 2% of the assets under management. Further, from your perspective, they don't do anything except maintain the trust and that only takes one hour per year.

Your next helper is the property management company. They actually do everything; collect the rents, pay the bills, do the repairs, etc. and most likely monthly, submit a bill for their services to the trust company. Their fees can easily be material, although it is all relative to the value of the investment. It is really the management company that stands in your stead, gets the real work done, and keeps you from inadvertently executing a prohibited transaction.

As a result, investing in real estate is not impossible, far from it. Rather, simply recognize that two other parties, both of whom need to be compensated, need to be present to make sure everything goes smoothly. Lastly, two of the big real estate investment advantages are: creation of long-term capital gains and periodic depreciation. Both of these advantages are lost when investing in real estate inside of an IRA.

CHAPTER 6 - ERRORS AND ERROR CORRECTION

THE ERROR

I have messed up my IRA distributions & the IRS is going to throw me jail!

Well, we all know intuitively that "benevolence" and "IRS" are an oxymoron. However, no one goes to jail for messing up their IRA distributions. On the other hand, your mess may incur additional taxes, penalties and interest that start at 10% and go as high as 50%, 100% or more. Further, often the first time most taxpayers learn that they have erred is receiving a delinquency notice from Irving (that's the great infallible IRS computer in the sky) saying in "unintelligible taxese" — YOU MESSED UP and SEND US ALL THE MONEY YOU HAVE IMMEDIATELY.

So, what can you do "up front" to avoid bankruptcy and suicide; what should you do when Irving taps you on your shoulder and what remedies are available to you so that you can tell Irving to go pick on some one else?

UP FRONT

Not dotting your "i's" and not crossing your "t's" is okay when sending Aunt Helen a birthday card. It is a disaster-waiting-to-happen in the IRA arena. This means keeping a permanent (as in forever) file or files on your IRAs with such boring documents as: account opening forms, your beneficiary designations, Form 8606 for every year you make non-deductible contributions, Form 5329 for every year you make distributions, all of your 1099-R's, the annual reporting statement received from your trustee every year and, believe it or not, a copy of your drivers license or birth certificate (you know, most of the time, how old you are — what makes you think the IRS believes you?). For right now (usually a 20, 30 or 40 year period) you do not have to study the contents of these files or even read them; just have them; you're going to need them.

Additionally, anyone taking distributions before age 59 ½ needs to keep more documents pertinent to whatever exception they are using to avoid the 10% surtax. Folks over 70 ½ need to keep (forever) their worksheets on how they computed their annual required minimum distributions.

IRVING CALLED

For starters, Irving never calls (at least not on the telephone). So, if you ever get a telephone call from the IRS hang up; better yet ask for their name and employee identification number; then they will hang up.

Irving is a computer; therefore according to the IRS, Irving is infallible and can do no wrong. That's why people get "Irv-o-grams" (actually a computer produced 4 - 6 page letter) which normally start of with: "Dear Mr. Taxpayer, we have reviewed your return and have found missing items X, Y & Z. We have taken the liberty of re-computing your tax liability. You owe us an additional gadzillion dollars. Please enclose a check for $6.6 gadzillion (in the enclosed envelope) within 30 days; or, (if you care to risk it), attempt to reach Ms. Havenochance at the phone number or address listed below.

Most of us would chose sess pool swimming or a home invasion before receiving one of these letters. However, all is not lost. With average care & patience, we can get your tax liability down to $1.2 gadzillion; or, with some advanced efforts, down to zero! Irving doesn't understand the word "mistake". He assumes that everything everyone tells him (except you) is the absolute truth. Therefore, if the numbers don't add up, you are wrong, therefore pay lots of money. However, if you write a nice letter to Ms. Havenochance you stand a chance of getting the issues resolved in your favor. It will more than likely take some months to receive a reply and if it is favorable, case closed, have a cocktail; the permanent file you built above saved you.

Conversely, Ms. Havenochance may write back effectively saying: "You still have no chance, now send me $6.6 gadzillion right now plus an additional $1.2 gadzillion for having wasted my time". Time to get out the big guns. Do not write back to Ms. Havenochance, you will just get another nasty-gram. Instead it is time to visit your local tax CPA or tax attorney. Do not call your broker, brother-in-law, custodian or trustee — they are not on your side; they are on their side.

A tax CPA or tax attorney has a variety of tools and corrective procedures (actually published by the IRS which they didn't tell you about) at their disposal which, for the most part, you are unaware. Not all IRA transactional errors are correctable, but a lot are. As a simple example, you're 75; wrote the letter to make your 2004 required minimum distribution to the custodian and then immediately; were hospitalized or went on a six week Carribean cruse. In either event, the letter never got sent and the distribution was never made. Irving brings out his 888 pound sledge hammer, actually called the excess accumulations tax, and assesses you 50% (ouch) of the distribution you didn't make, plus interest, plus an under-payment penalty of 20% (but only if Irving was in a bad mood). If your distribution was supposed to $20,000; that's not quite a gadzillion, just about $7,000 to $8,000. This situation happens everyday and is very solvable. Your representative (not you) can take the correct steps using the correct procedures and get all of the above waived.

Ms. Havenochance's supervisor will review your representative's correspondence and will carefully measure the specific facts & circumstances as well as attempt to determine your intent and will most often render a result that is partially or wholly in your favor.

THE ALERT

So what is an "alert". The IRS believes that taxpayers are obligated to play by the rules and there are statutes to support that position. At the same time, the IRS actually receives virtually all of the information about your tax situation electronically. And, the complexities of any individual tax situation are likely known by you but will not be obvious to Irving (the IRS computer) as he goes about his merry way attempting all kinds of electronic document matching. Well, if you know about the problem in advance then let's get ahead of Irving from the start by attaching a document to your tax return. It is called an "alert" [105]. Simply prepare it and attach it to your 1040. As an example:

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105 To the best of my knowledge, the only tax return document prepared by the taxpayer that does not have an IRS form number.

ALERT

Philip S. Pittman 268-50-9612
Amy S. Pittman 271-54-8269

Commencing in March, 2004, Amy S. Pittman commenced pre-59½ distributions from her IRA pursuant to IRC §72(t)(2)(A)(iv); "substantially equal periodic payments" and has made the correct distributions in both 2004 and 2005 totaling $63,492. Furthermore, Ms. Pittman has continued to make distributions in 2006 of the correct amounts in order to remain compliant with IRC §72(t)(2)(A)(iv) and Revenue Ruling 2002-62.

In April, 2005, Ms. Pittman made a 2004 spousal IRA contribution of $3500 and further instructed the trustee / custodian to open a new IRA account to house that $3500 as well as future planned contributions. The trustee / custodian errantly deposited the $3500 not into a new IRA account, but instead deposited the $3500 into Ms. Pittman's IRA account from which substantially equal periodic payments were being made. Subsequent to the errant deposit, the trustee / custodian observed and corrected the error by opening a new IRA account for Ms. Pittman and transferred $3500 from the existing IRA account to the new and separate IRA account.

This error technically causes a "modification" pursuant to Revenue Ruling 2002-62; Section 2.02(e)(I): "Thus, a modification to the series of payments will occur if, after such date, there is (i) any addition to the account balance other than gains or losses...".

Irrespective of the above, the Taxpayers believe that they did all that they reasonably could do to insure that a "modification" did not occur and further, Ms. Pittman did not intend to cause a "modification" to occur. Further, the Taxpayers rely upon: Wood v. Commissioner (93 TC 114) as well as private letter rulings 2005-03036 and 2006-16046. All sources cited are conceptually consistent in permitting taxpayers, in concert with their trustee / custodians, to correct bookkeeping and transactional errors back to their original intent.

Accordingly, this amended return and alert are filed to inform the IRS of this circumstance and request that the 10% surtax pursuant to IRC §72(t)(4) not be applied.

There is absolutely no question; the IRS does not like alerts as they more-or-less take on the attributes of a pre-emptive strike. Nonetheless, they do work but should be implemented very carefully in concert with advice from your tax CPA or tax attorney.

REVERSIBILITY AND ERROR CORRECTION

In many cases, the Internal Revenue Code or the regulations provide methods for a taxpayer to reverse course, sometimes years after an initial tax decision has been made. This is NOT one of those cases. Within our general context of discussion, SEPPs are never reversible. All readers should consider the launch of a SEPP program as a one-time (per SEPP program) one way street that can not be reversed. However, errors happen every day. Errors in the execution of a SEPP plan can be disastrous and should be avoided at all costs. That being said, some one with a SEPP plan is going to err and we will therefore spend a little time discussing error correction techniques.

- IRC §408(d)(3) — the Annual rollover. A taxpayer can always make a withdrawal from a deferred account and replace those withdrawn funds within 60 calendar days. This is then classified as a rollover[106] & each taxpayer is allowed one rollover per year. It is not our intent to make use of this feature; however, it can be used to provide a limited time window in which correct mistakes. As an example, a taxpayer was supposed to withdraw $67,000 within a tax year and, in error, withdraws $76,000; $9,000 too much. The taxpayer may redeposit the $9,000 but only if he detects the error within 60 days.

- Revenue Procedure 2003-16. This revenue procedure was issued by the IRS in response to Congress modifying IRC §408(d)(3) with the addition of (I) as follows:

> *(I) Waiver of 60-day requirement*
>
> *The Secretary may waive the 60-day requirement under subparagraphs (A) and (D) where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement.*

> *The Service will issue a ruling waiving the 60-day rollover requirement in cases where failure to waive such requirement would be against equity or good conscience, including casualty, disaster or other events beyond the reasonable control of the taxpayer. In determing whether to grant a waiver, the Service will consider all relevant facts and circumstances, including: (1) errors committed by a financial institution...(2) inability to complete a rollover due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country or postal error; (3) the use of the amount distributed (for example, in the case of payment by check, whether the check was cashed); and (4) the time elapsed since the distribution occurred.*

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106 IRC §408(d)(3)(A)(i).

What this really says is that taxpayers should always strive to complete their rollovers within the 60 calendar day time limit; however, if some unforeseen (and usually uncontrollable) circumstance occurs which reasonably prevents the taxpayer from concluding the rollover on a timely basis, the IRS will, on a case-by-case basis, consider granting a "stretch" of the 60 day rollover window.

Thus far the IRS has issued a variety of waivers which to-date have all focused on: financial institution errors and mis-communication, natural catastrophes and hospitalization / incapacitation of the taxpayer circumstances. In addition, the Revenue Procedure grants automatic approval for simple administrative errors committed by financial institutions. As a result, we now have a mechanism in place to stretch the 60 day rollover window. As always, there are rules:

(1) A waiver is (potentially) obtained by the filing a of a waiver request to the Internal Revenue Service. This waiver request is not unlike a private letter ruling request; however, it is substantially shorter & simpler. In addition, for 2009, the IRS requires a check for either $500, $1500 or $3000[107] in order to review the request.

(2) The granting of the waiver is a "facts & circumstances" test which implies that one must fully describe all of the relevant facts and circumstances within the waiver request. We already know that the obvious situations will be approved; e.g. natural catastrophes, hospitalizations, etc. But, what about some not so obvious situations?

As an example, John designed a SEPP plan to distribute $75,000 per year and was doing so by making individual distribution requests to his trustee throughout the year timed to meet his specific financial needs. He inadvertently made an extra distribution in November; thus over-distributing and does not discover the error until the following March when he commences working on his tax return. Is John's situation covered here? The short answer is we don't know. We would like to think so but we can not be sure as no waiver requests have been published that appear on point.

- Private Letter Rulings. On January 25, 2005, the Internal Revenue Service issued private letter ruling 2005-03036; the 1st of its kind regarding inter-year errors for a taxpayer distributing from his IRA using a substantially equal periodic payment plan pursuant to IRC §72(t)(2)(A)(iv). This ruling is very important for four different reasons as will be discussed following.

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[107] Revenue Procedure 2009-8, Section 6.01(3). Separate and distinct from private letter rulings (which have a filing fee of $10,000), "waivers of the 60-day rollover period" are evidently thought to be less complicated and therefore have a different fee schedule. Extending the 60-day rollover period, when the rollover amount is less than $50,000 costs $500; from $50,000 to $99,999 the cost is $1,500, and when the rollover amount is $100,000 or more the fee is $3,000.

To paraphrase the ruling, the taxpayer designed his distribution plan pursuant to Revenue Ruling 2002-62; as such the taxpayer's substantially equal periodic payment plan itself was not in question. To chose a notional amount, the taxpayer was therefore required to distribute $60,000 per year in 2003, 2004 and so forth. Earlier in 2003, the taxpayer requested that his trustee make "aggregate distribution[s]" in a notional amount of $40,000. This amount was distributed. Late in 2003, the taxpayer met with his trustee and completed the necessary trustee forms requesting that the remainderman $20,000 be distributed before December 31st, 2003 in order to complete his IRA distributions for 2003. The trustee erred and did not distribute the $20,000 in December, 2003 and did not discover its error until early 2004. Immediately upon discovering the error, the trustee did distribute the $20,000. Further, the correct amount of $60,000 was distributed on 2004. All else being equal, this raised two central questions:

(1) The taxpayer's reportable income was understated by $20,000 in 2003 and overstated by $20,000 in 2004. How should this be handled?

(2) Did the trustee's error constitute a modification of the taxpayer's substantially equal periodic payment plan pursuant to IRC §72(t)(4)?

The IRS ruled in the taxpayer's favor by stating: "[the taxpayer] did all that he could in order to ensure that he received the balance of the annual payment from IRA X and had no reason to believe the [trustee] would not make the distribution as he requested. [The taxpayer] did not intend to modify the series of substantially equal periodic payments...Rather, the modification is due to the failure of [the trustee] to make the remaining distribution...Accordingly, we conclude that the failure to distribute the entire required annual payment...for the calendar year and the subsequent "make up" distribution [in the subsequent year] ...will not be considered a modification of a series of substantially equal periodic payments under Code section 72(t)(2)(A)(iv) and, therefore will not be subject to the 10 percent additional tax imposed on premature distributions under section 72(t)(1) of the Code."

We can learn four very important issues or concepts from this ruling:

(1) Documentation is critical. In this particular case, the request for the final distribution of 2003 was detailed on a trustee supplied distribution form in writing and was producible by the taxpayer therefore clearly establishing his intent and further, the "passing of the blame" onto his trustee. Had the taxpayer not been able to produce this documentation, we suspect that his case would have been severely diminished. Therefore, always communicate with your trustee in writing and keep copies of all of those documents.

(2) Albeit a sidelight, implicit in the ruling is the issue of intra-year distribution timing. We don't know precisely how the taxpayer defined and documented his distribution plan; however, it was apparent from the ruling that the IRS did not care. The IRS's focus was 100% on the annual distribution amount. Conversely, it showed no concern over the intra-year timing or frequency of distributions.

(3) How should the taxpayer prepare his 2003 and 3004 tax returns? In this case, the IRS

effectively said "let sleeping dogs lie" meaning that the taxpayer should only report $40,000 for 2003 and report $80,000[108] for 2004.

(4) Where does the IRS obtain its authority to rule affirmatively in this case? In short, they appear to have none[109]; nor did the IRS express that they had any; they simply ruled. Potentially, the IRS should have said "sorry, your trustee's errors are your errors, therefore you have modified your distribution plan; take the issue up with your trustee." Maybe we are seeing a new and more taxpayer friendly IRS? We don't really know, however, in this case, based on the facts presented, a fair and equitable solution was reached.

- Surtax --- A taxpayer can always intentionally stop the SEPP withdrawals at any time and suffer the wrath of IRC §72(t)(4); namely the application of the 10% surtax plus statutory interest. Again, it is not our intention to take advantage of this feature; further, it is pretty hard to conceive of this strategy as any kind of advantage at all[110].

In summary, there are limited corrective mechanisms available for SEPP program errors & taxpayers should know that they exist. However, our beginning position should still apply; always think of a SEPP program as a one-way street — irrevocable. Better to have not made an error than to contemplate whether or not the error made is correctable. Further, the IRC does not differentiate between a change in taxpayer circumstances and errors. Errors can be mistakes in theory as well as practice. A taxpayer may believe he or she has properly interpreted how to apply one of the approved methods. The taxpayer may be wrong resulting in a "theory error". Or, a taxpayer may have the theory down pat and properly interpreted but may make a date or math computational error. This, then becomes a "practice error". In either event, the IRC treats changes in taxpayer circumstance, theory errors and practice errors equally. All three events are considered a "modification" therefore resulting in the application of the 10% surtax plus interest.

Although there are limited error correction abilities, some are statutory rights; e.g. the annual rollover, and

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108 In our opinion, the IRS has erred here. If the IRS, rightfully or wrongly, is going to grant relief from the 10% additional tax under IRC §72(t)(1) & (4); they should have also granted relief to the cash basis taxpayer to record an accrual of the $20,000 into 2003. Otherwise, the taxpayer is potentially subjected to additional ordinary income taxes in 2004 at his marginally highest tax bracket that would otherwise not be due if the same amounts were properly recognized in 2003.

109 The IRS has authority to grant relief in a variety of circumstances where unintentional errors have been committed; e.g. Rev. Proc. 2003-16 to stretch the 60 day rollover window or Reg. §54.4974-2 Q&A7 (1)&(2) can be used to waive the 50% penalty for under-distributing from an IRA after attaining age 72 . However, we can find no such authority of similar nature which grants the IRS the ability to rule / grant relief with respect to a modification of a series of substantially equal periodic payments.

110 One potential situation exists where a taxpayer has dutifully planned out the next 5 to 10 years and has designed a SEPP program to meet those needs; launching same in the very recent past. Then, a large & totally unexpected windfall occurs; e.g. some one has to win the Powerball lottery. In this type of situation, it may be beneficial to terminate the SEPP & pay the penalty; however, this predominately becomes a tax bracket analysis problem.

some are “chancy”; e.g. filing for relief under Rev. Proc. 2003-16 or a private letter ruling. Nonetheless, when an error is committed, ultimately the IRS is going to look closely at it and pass judgement; either “yes” or “no”. There is no maybe or in-between. Lastly, should the IRS rule “no”, the 10% penalty plus interest will apply. The IRS has no authority to waive these amounts. Thus, the finality with which the surtax is imposed suggests some strategies for taxpayers:

(1) plan, plan and then re-plan your cash flows as well as SEPP program design. When you are sure you’re done, re-plan it again.

(2) Document your SEPP program in a letter or contract with yourself spelling out all of the details right down to the plan assumptions, account numbers and balances.

(3) Taxpayers who are the least bit hesitant or uncertain should obtain a professional review of the intended program including consideration of receiving an opinion letter from a licensed CPA or tax attorney.

CHAPTER 7 - ADMINISTRATION

RECORD KEEPING

If there was ever a good time for record keeping, this is it. Once you have designed your SEPP program, you need to document it. The detail documentation should be designed to meet several needs: your own specifics, accountant's or lawyer's needs if you use one, and lastly for the IRS should that doorbell ever ring. The easiest way to do this is to use the contract from Chapter 6 as a beginning template. Then add to it any and all specific issues you think appropriate as well as all of your mathematical worksheets and copies of account statements.

The above really documents your plan design. Next, you should also document plan execution by logging all distributions from your SEPP IRA and copies of your 1099R's received. This is also a good cross-check / control mechanism to test, at least once a year, that what you expected to have happen, did in fact happen correctly.

TRUSTEE COMMUNICATIONS

These communications should always, always be in writing. Even if a phone conversation or e-mail seems to have handled your request, always write a follow-up letter to your trustee[111] confirming your agreement on steps and actions that are to occur. Unfortunately, there are a variety of professionals you will potentially deal with: trustees, account custodians, plan administrators, brokers, etc. All of these people and their respective institutions are considered your sub-contractors and agents. Thus, any error committed by any one of these entities effectively becomes your error[112]. Sometimes these errors are correctable, sometimes they are not. Thus, why invite a difficult situation when a simple letter will suffice.

TAX MATTERS

The source from which you are withdrawing SEPP dollars must issue you a form 1099-R on or before January 31st for the year just ended. Other than the amounts being correct, the most important box on the form is "Box 7: Distribution Code". It should have a "2" in it. Referring to the guide for distribution codes, we find that a "2" means "Early distribution exception applies (under age 59 ½)(You need not file Form 5329)". Conversely, if box 7 is blank or contains any code other than a "2", you will

[111] In this case, we are using the word "trustee" generically to mean whichever responsible party you might be dealing with to execute SEPP transactions. This may be the actual trustee, a custodian, record keeper, a plan administrator, or your personal broker.

[112] A trustee or custodial error is not a valid defense to an IRS challenge to your SEPP program. The trustee or custodian may have professionally erred and you may have recourse against that person or institution after you have paid the IRS; just be prepared to prove it.

be required to complete and file Form 5329[113].

Some trustees / custodians are willing to put the “2" in box 7 via a simple written request from you. Take care of this early in the year. Do not wait until you receive your 1099-R, see that it is incorrect, and then get on the phone. Other trustees / custodians will require more information before they will comply with your request (another good reason to have written yourself a thorough SEPP contract letter).

SEPP withdrawals are always reportable as unearned ordinary income, currently on lines 4a and 4b of IRS form 1040. If your SEPP withdrawal is 100% taxable, then the same amount goes on both line 4a and 4b. If you have basis in the account(s) from which SEPP withdrawals are being made, then place the total amount withdrawn on line 4a and the lesser taxable amount on 4b also completing Form 8606.

Taxes will always be due because SEPP withdrawals are always reportable as ordinary income. How much tax will be due has nothing to do with the SEPP withdrawal itself; instead, the amount of tax due is governed by your overall tax situation including all other sources of income as well as deductions and exemptions. There are two ways for taxpayers to meet their tax obligations in this regard. One, most trustees offer to withhold federal and state taxes from your distributions; not unlike the manner in which federal and state taxes were withheld from your paychecks when employed. The taxpayer has the opportunity to avail himself of this process or to decline. Second, taxpayers can always make quarterly estimated payments[114] at the federal and state levels.

STATE TAXATION

At the federal level, SEPPs are always treated as ordinary unearned income. This is not always the case at the state level. Some states[115] offer whole or partial exclusions, credits or otherwise afford the taxpayer favorable tax treatment on SEPP distributions. The author is not suggesting that anyone should physically move states simply to take advantage of favorable tax treatment; however, it has been known to happen. Instead, some states, which might be considered “moderate tax states” all of sudden start to look like “zero tax states[116]” when a vast majority of one’s taxable income is from SEPPs.

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113 If you are required to complete Form 5329, please do not over look it. In the absence of this form and an absence of the “2" in box 7, the IRS computers have a nasty habit of automatically issuing deficiency notices for 10% plus interest for the amount withdrawn.

114 Estimated tax payments are due 15 calendar days after the close of the somewhat illogical IRS definition of a quarter; April 15th , June 15th , October 15th and January 15th. Let’s see everyone count on their fingers and explain to me why June 15th isn’t July 15th .

115 Unfortunately this is an ever changing landscape; otherwise we would have been happy to provide a table of states with favorable treatment. This is a situation where it is very important to read those state income tax filing instructions. You don’t want to miss an income exclusion for which you are eligible.

116 Colorado and Illinois immediately come to mind. There are most likely several more.

THE END

My sincere congratulations on your making it through. It was a tough haul, but I hope you will think it was worthwhile. Needless-to-say, we attempted to think through SEPPs from every conceivable perspective in order to anticipate your every question. We hope we covered the first 98 questions so that you only have 2 left. We will be happy to answer those last two questions as well as your criticisms and recommendations. The author can be reached at themarblegroup@wispertel.net. Lastly, some final thoughts and opinions:

About the only thing worse than reading the Practical Guide was writing it. Everyone has a cross or duty in life and I guess the Practical Guide is mine. Without question, I have great respect for authors of all types & stripes. Writing is difficult only surpassed by the proofing which is even harder duty. As hard as I have tried I am certain there are still a dozen typographical errors in there. As you find them please let me know and I will make the corrections.

Substantially Equal Periodic Payments are your constitutional right. It is federal statute enacted by Congress and signed by President Ronald Reagan. Back in 1986 this was not a big issue because IRAs were still relatively small business; now 35 years later it is a really big issue with a 20 trillion dollar price tag[117]; a high percentage of which is owned by taxpayers under the age of 60. The author believes this website and all of its materials (all of which are free for the taking) are needed in that you, the taxpayers, have received a huge disservice from the IRS:

(1) The rules (and traps) are now found in one ten page (double spaced) IRS publication, Notice 2022-6; not easily found because 99% of taxpayers do not know to go looking for it and it is woefully short — given the complexity of the subject matter it should be 50 pages (single spaced);

(2) SEPPs are comparatively complex and therefore mistakes are easy to make, however, the costs of a error are draconian in short order approaching 100% or more of one's original annual distribution.

(3) There is no way to submit your plan to get an official stamp of approval from the IRS; they flat out won't do it.

(4) Calling the IRS for help is an exercise in futility; call the general number and they are clueless; call the Tax Exempt & Governmental Entities department --- they don't answer and they don't call back.

(5) If you are audited, there is high likelihood the IRS will challenge your SEPP plan calling it "non-compliant". Pay up or hire a tax attorney to defend you.

Much of your rights have effectively been taken away; Congress said you have got it; the IRS has basically said: "Not on my watch.". You are virtually forced to either abandon this course of

[117] Can you believe it. Aggregate totals of IRAs @ $20 trillion are now larger than the US national debt @ $19 trillion.

action, or, hire a not-so-easily-found true professional on §72(t) issues to get it done precisely right.

My hope is the guide and other related materials will provide some help in this regard. Knowledge is ammo; please use it wisely.

Lastly, I fully realize that this stuff is really boring so in order to stay awake, I have periodically made some, potentially ill-fated, attempts at humor. My excuse — I am an accountant; I am not a standup comedian — I tried — if you don't like the humor send me some substitute language and I will use it.

Good luck.