

# Rule 72(t) and Revenue Ruling 2002-62

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Many clients who have chosen to take Substantially Equal Periodic Payments (SEPP) exception under IRS Code 72 (t) have discovered that their needs have changed. Some no longer need to take such large distributions from their IRAs. Other investors have been faced with the potential of running out of funds before their payment period expires or are dealing with the possibility of having very little money left for future years in retirement. However, once begun, the SEPP distributions must continue for five years or until age 59½, whichever is longer. Any modification to the SEPP schedule prior to the completion of this timeframe will incur a 10 percent penalty to all distributions retroactive to the first distribution as well as interest on the penalty.

The IRS released Revenue Ruling 2002-62 to address these situations. Let's review this revenue ruling and determine the potential impact it will have for those who want to decrease the amount of their SEPP distributions.

1. If an individual depletes their IRA while following an acceptable method of taking SEPPs, the IRS will not treat the cessation as a modification. In this situation, the investor will face no additional taxes or penalties.
2. Any investor currently taking distributions using the SEPP annuitization or amortization method may switch to the required minimum distribution (RMD) calculation method in any subsequent year. Remember, however, that once this change is elected, it must be followed for all subsequent years. Because the RMD calculation method results in the lowest payout amount, IRA accountholders will be able to keep more funds in their accounts for the future.
3. Under the revenue ruling, you may choose one of three life expectancy tables to determine your RMD - the Uniform Table, the Single Life Table or the Joint and Last Survivor Table. At Wells Fargo Advisors, we will calculate these SEPP RMDs using the Uniform Table or the Single Life Table. If you desire other calculations, please contact your tax advisor. Remember, too, that once a table is chosen, that same table must be used for all subsequent years.
4. The language of the rule also suggests that using the December 31 balance of the prior year is an acceptable method of valuing the account for purposes of the RMD calculation. At Wells Fargo Advisors, we will use this balance for calculation of SEPP illustrations for clients wishing to recalculate their current payment schedule. Those investors desiring to use other balances should seek the assistance of their tax advisors.

Please contact me if I can be of further assistance.

William J. Berrall, CFP

Senior Vice President - Investment Officer

Financial Advisor

20800 Swenson Drive #200

Waukesha, WI 53186

(262) 798-3786

(800) 323-1410

[www.berrallkongsgroup.com](http://www.berrallkongsgroup.com)

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Clients often ask when they can change from the annuitization or amortization method to the RMD method. The answer is a taxpayer may switch to the RMD method at any time during the calendar year as long as the taxpayer has not taken more than the RMD method requires for that calendar year. Please note: The RMD method is a type of calculation. Taking more or less than this calculated amount will be considered a modification and may result in a penalty and interest retroactive to the first SEPP distribution.

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**RMD example:** John begins his SEPP in 2008 based on an annuitization method and has been taking \$20,000 on an annual basis with monthly payments of \$1,666.67. In April of 2010, he tells his FA he would like to switch to the RMD method. The RMD calculation amounts to \$8,000 for the year. He has already taken four monthly payments in 2010 equaling \$6,666.68 (\$1,666.67 X 4). John can take advantage of the Revenue Ruling 2002-62 this year and must take the remaining balance of \$1,333.32 (\$8,000- \$6,666.68) from his IRA by year-end to satisfy the RMD method of calculation.

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5. One important section of this ruling deals with the ceiling on interest rates when initially calculating SEPP distributions using either the annuitization or amortization method. This rule clearly states that the interest rate that may be used must be one that is not more than 120 percent of the applicable federal mid-term rate (AFR), for either of the two months immediately preceding the month that the distribution begins.

To learn more about these regulations, please contact your Financial Advisor.

We will welcome the opportunity to work with you, your CPA, attorney and/or tax advisor to determine how you might benefit from this revenue ruling.

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