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Using Revenue Ruling 2002-62 to change your SEPP distributions

Many clients taking Substantially Equal Periodic Payments (SEPP) under Internal Revenue Code (IRC) 72(t) have discovered that their income needs have changed. Some no longer need to take such large distributions from their IRAs. Some may have chosen to return to work. Remember, IRC regulations state that once you begin taking SEPP distributions they must continue for five years or until age 59½, whichever is longer. Any modifcation to the SEPP schedule prior to the completion of this timeframe will incur a 10% additional tax for early distributions (10% additional tax) meaning those taken prior to age 59½. There will also be interest applied to all pre-59½ distributions, retroactive to the first distribution. However, Revenue Ruling 2002-62 allows you to potentially lower the amount you are receiving without being considered a modifcation.

Important changes addressed in Revenue Ruling 2002-62

The following information highlights important aspects of this revenue ruling so you can determine the potential impact it will have if you want to change the amount of your SEPP distributions.

1. If you deplete your IRA(s) from which your SEPPs were based while following an acceptable method of taking SEPPs, the IRS will not treat the cessation as a modifcation. In this situation, you will face no additional taxes.
2. You may switch from the annuitization or amortization method you are currently using to the required minimum distribution (RMD) calculation method. Remember, that once this change is elected, it must be followed for all subsequent years. The annual payment is redetermined each year and the amount will vary from year to year. Because the RMD calculation method often results in the lowest payout amount, using this method may allow you to keep more funds in your IRA for the future.
3. 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. 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 generally use this balance for calculation of SEPP illustrations for clients wishing to recalculate their current payment schedule.

When can I switch to the RMD method?

Clients often ask when they can change from the annuitization or amortization method to the RMD method. The answer is you may switch to the RMD method at any time during the calendar year as long as you have not taken more than the RMD method requires for that calendar year.

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 10% additional tax and interest retroactive to the first SEPP distribution.

Hypothetical RMD calculation example:

Ben began his SEPP in 2018 based on an annuitization method and has been taking monthly payments of $2,000. In April of 2020, he tells his FA he would like to switch to the RMD method after consulting his tax advisor. The RMD calculation amount is $10,000 for the year. He has already taken four monthly payments in 2020 equaling $8,000 ($2,000 X 4) so he can switch to the RMD method. He must take the remaining balance of $2,000 ($10,000 – $8,000) from his IRA by year-end. Ben will have a new calculation run to determine the amount needed to satisfy his SEPP distribution requirement for 2021.

Keep in mind

- A switch to the RMD calculation method will change the amount you will receive.
- Once you elect to switch to the RMD method you must have a new calculation run every year until the end of your SEPP commitment.
- Switching to the RMD method does not increase or decreasethe length of your SEPP commitment. It only changes the calculation method and amount you will receive.
- All other rules for taking SEPP still apply, so no additional contributions, transfers, or rollovers allowed.
- You cannot distribute more, or less, than the calculated amount.
- Seek tax and legal advice if you are getting a divorce while taking SEPPs. The Revenue Ruling states that any nontaxable transfer of a portion of the account balance to another retirement plan **will** be a modifcation of the series.

Talk with Wells Fargo Advisors

Please contact your financial advisor to learn more about this revenue ruling. 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.

With you every step of the way

Everyone has a diferent vision of retirement that requires a unique financial strategy. Wells Fargo Advisors can support you in your retirement planning process by providing the guidance needed to make more informed choices. We will meet with you and help create a comprehensive plan that takes into account your complete financial picture. Your financial advisor will be with you every step of the way to meet to review your progress and adapt your plan as needed. Working together, we'll design and implement a retirement plan that can help you live out your unique vision of retirement.

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