Arnold v. Commissioner, 111 T. C. 250 (1998)

An impermissible modification to a series of substantially equal periodic payments from an IRA within the 5-year period from the first distribution triggers the 10% recapture tax under section 72(t)(4).

Summary

Arnold v. Commissioner addresses the tax implications of modifying a series of substantially equal periodic payments from an Individual Retirement Account (IRA). Robert Arnold began receiving annual distributions from his IRA at age 55, intending to avoid the 10% tax on premature distributions under section 72(t)(1) by qualifying for the exception in section 72(t)(2)(A)(iv). After receiving five annual payments, he took an additional distribution before the end of the 5-year period, which the IRS deemed an impermissible modification, thus triggering the 10% recapture tax on all prior distributions under section 72(t)(4). The court upheld the IRS's position, ruling that the November 1993 distribution did not qualify as a cost-of-living adjustment and was not exempt from the recapture tax.

Facts

Robert Arnold, after selling his business and retiring, rolled his pension into an IRA. In December 1989, at age 55, he began taking annual distributions of $44,000 from his IRA to avoid the 10% tax on premature distributions under section 72(t)(1). After receiving five such distributions, Arnold took an additional $6,776 in November 1993, following the bankruptcy of Sowhite Chemical, which had been making monthly payments to him. This distribution occurred before the end of the 5-year period from the first distribution and after Arnold had reached age 59-1/2.

Procedural History

The IRS issued a notice of deficiency to Arnold, imposing a 10% recapture tax on all distributions received prior to him reaching age 59-1/2, claiming the November 1993 distribution impermissibly modified the series of substantially equal periodic payments. Arnold contested this in the U. S. Tax Court, arguing the series was completed or the additional distribution was a cost-of-living adjustment.

Issue(s)

1. Whether the November 1993 distribution from Arnold's IRA impermissibly modified a series of substantially equal periodic payments under section 72(t)(4)?
2. Whether the November 1993 distribution constituted a permissible cost-of-living adjustment?

Holding

1. Yes, because the distribution occurred within the 5-year period from the first

© 2025 SCOTUSreports.com. All rights reserved.

distribution, triggering the recapture tax under section 72(t)(4).
2. No, because Arnold failed to prove that the November 1993 distribution was a permissible cost-of-living adjustment.

Court's Reasoning

The court applied section 72(t)(4), which imposes a recapture tax if the series of substantially equal periodic payments is modified within 5 years from the first distribution. The court emphasized that the 5-year period does not end with the fifth distribution but runs for 5 years from the date of the first distribution. Arnold's November 1993 distribution occurred within this period, thus triggering the recapture tax. The court rejected Arnold's argument that the series was completed after five payments, citing legislative history indicating the full 5-year period must be observed. Regarding the cost-of-living adjustment argument, the court noted Arnold's failure to provide evidence supporting this claim and found the distribution was instead motivated by financial hardship, which is not an exception under section 72(t). The court quoted the legislative purpose of section 72(t) to discourage premature distributions from IRAs, supporting its decision to uphold the recapture tax.

Practical Implications

This decision underscores the importance of adhering to the 5-year rule under section 72(t)(4) when taking distributions from an IRA to avoid the 10% recapture tax. Practitioners must advise clients on the strict requirements of maintaining a series of substantially equal periodic payments and the consequences of any modification within the 5-year period. The ruling also clarifies that financial hardship does not exempt a distribution from the recapture tax, and any claim of a cost-of-living adjustment must be substantiated. Subsequent cases, such as Duffy v. Commissioner and Pulliam v. Commissioner, have cited Arnold in upholding the application of the recapture tax for similar violations.

© 2025 SCOTUSreports.com. All rights reserved.