
Focus on 457



Published by Great-West/BenefitsCorp, Specialists in Government Defined Contribution Plans

Edited by
Gregory E. Seller, Senior Vice President,
Government Markets (800) 933-9808 &
Marilyn R. Collister, Assistant Vice President,
Plan Design & Compliance
(800) 537-2033, Ext. 73819

Volume 16
Number 6
May 30, 2003

IRS ISSUES PROPOSED REGULATIONS ON DEEMED IRAS

Proposed regulations were issued May 20, 2003 with respect to Deemed IRAs under Internal Revenue Code (Code) section 408(q). These regulations are intended to provide guidance regarding individual retirement accounts or annuities added to qualified employer plans and will affect administrators of, participants in, and beneficiaries of qualified employer plans choosing to add a Deemed IRA feature to their plan.

As described in previous Focus on 457 articles, an employer sponsoring a “qualified employer plan” may offer “Deemed IRAs” to employees beginning in 2003. Deemed IRAs allow employees to make “voluntary employee contributions” to a separate Deemed IRA account under the plan so long as the Deemed IRA meets the applicable requirements for a traditional IRA under Code section 408 or a Roth IRA under Code section 408(A). Deemed IRAs must also comply with the requirements of new Code section 408(q).

For purposes of the Deemed IRA rules, the term “qualified employer plan” includes 401(a)/(k) qualified retirement plans, 403(a) annuity plans, 403(b) tax-sheltered annuity plans, and governmental 457(b) deferred compensation plans. “Voluntary employee contributions” are defined as any voluntary contributions designated as Deemed IRA contributions under Code section 408(q) made by individual employees in a qualified employer plan.

In general, the proposed regulations provide that a qualified employer plan and a Deemed IRA are to be treated as separate entities under the Code. Thus, the qualified plan must satisfy all the same rules that would apply to that type of plan if there were no Deemed IRA. Likewise, the Deemed IRA portion of the qualified employer plan must satisfy the IRA rules of Code sections 408 and 408(A), respectively, not the rules applicable to plans under Code sections 401(a)/(k), 403(a), 403(b), or 457(b).

Under one of the most restrictive provisions in the proposed regulations, the entire plan will become disqualified if any individual employee's Deemed IRA fails to satisfy the applicable IRA rules. It appears that circumstances over which the plan has no control could disqualify the entire plan unless the error is corrected through the Employee Plans Compliance Resolution System (EPCRS) or other similar administrative practice. EPCRS will be updated to include provisions for correcting qualification defects with respect to plans with Deemed IRAs.

Likewise, if the Deemed IRA assets are commingled with the plan assets for investment purposes, and the plan becomes disqualified, either in form or in operation, then none of individual accounts or annuities maintained under the plan will be treated as a Deemed IRA. If the assets were not commingled, and all of the applicable rules for traditional IRAs or Roth IRAs, as applicable, have been satisfied, then the Deemed IRA accounts are treated as individual IRAs.

The Deemed IRA and the qualified plan are treated as separate entities with respect to the following rules:

Distribution Rules

- The IRA distribution rules apply to Deemed IRA distributions. Distributions from Deemed IRAs must be allowed at any time, subject to the 10% premature distribution penalty.
- The distribution restrictions applicable to the employer's plan will continue to apply even if a Deemed IRA feature is added to the plan.

Premature Distribution Penalty under Code section 72(t)

- The 10% penalty for early distributions is applied separately to a Deemed IRA and the qualified plan, and the rules for IRAs differ from the qualified plan rules.
- A premature withdrawal from a Deemed IRA that is part of a governmental 457(b) plan would be subject to the IRA penalties in section 72(t) even though the plan assets are exempt from the 10% penalty.

Required Minimum Distributions

- Required minimum distributions from the Deemed IRA must begin at age 70 ½ even if the individual is still employed.
- Required minimum distributions are not required to begin earlier than required under the rules applicable to employer sponsored plans. Generally, this is the later of age 70 ½ or separation from employment.

Rollovers and Transfers

- The rules for rollovers and transfers to and from Deemed IRAs are the same as the rules for other IRAs. Thus, for example, an employee may receive a distribution from his or her Deemed IRA account balance and roll it over to an eligible retirement plan regardless of whether that employee may receive a distribution of any other plan benefits.

Nondiscrimination

- The availability of a Deemed IRA is not a benefit, right or feature of the qualified employer plan and thus does not impact nondiscrimination testing.

Separate Trust Agreement or Annuity Contract

- Any trust holding Deemed IRA assets must be separate from the trust holding the other assets of the qualified employer plan. The Deemed IRA trust must be created in the U.S. for the exclusive benefit of the participants and the written document creating the trust must satisfy the general IRA rules. The plan may use a “group” trust for the Deemed IRA assets rather than a separate trust for each individual IRA owner as long as separate accounts are maintained for each Deemed IRA owner.

Note: Under the rules applicable to individual retirement accounts, the trustee must be a bank as defined in Code section 408(n), or such other person who demonstrates to the satisfaction of the Secretary that the manner in which such other person will administer the trust will be consistent with the requirements of section 408.

- Deemed IRAs that are individual retirement annuities may be held under a single annuity contract or under separate annuity contracts for each individual Deemed IRA owner. The annuity contract must, however, be separate from any annuity contract(s) for the qualified employer plan and separate accounts must be maintained for each IRA owner.

Deductibility of IRA Contributions

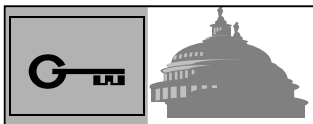
- The deductibility of voluntary employee contributions to a deemed traditional IRA is determined in the same manner as if it were made to any other traditional IRA. The income limits imposed by Code section 219(g) apply to the Deemed IRA. The individual employee is still responsible for determining whether his or her contribution is deductible and making the proper entries on his or her tax return.

In addition to the disqualification issues discussed above, the regulations provide two other exceptions to the general rule that the qualified employer plan and the Deemed IRA are separate entities subject to their separate rules.

- The regulations state that the qualified employer plan document must contain the deemed IRA provisions. Additionally, the Deemed IRA must be in effect at the time that Deemed IRA contributions are accepted. See the article entitled “Deemed IRAs Allowed Beginning in 2003” in Volume 16, Number 1 of *Focus on 457*, dated January 1, 2003 for a discussion of Revenue Procedure 2003-13 containing sample plan document language drafted by the IRS.
- The assets of the Deemed IRA may be commingled with the plan’s assets for investment purposes. Separate accounts must be maintained such that any gains or losses are allocated properly to the separate accounts of the employee under the Deemed IRA and the plan. The proposed regulations do not indicate that Deemed IRA assets may be invested in any of the plan’s investment options that would not be available to a traditional or Roth IRA under Code sections 408 and 408A respectively.

Comments on these proposed regulations may be submitted to the IRS prior to August 18, 2003. Please notify us with any questions or concerns you may have with respect to the proposals. Based upon the responses received, Great-West will be filing written comments with the IRS on behalf of our clients. For more information, please contact either one of us or your local relationship partner listed below.

Cathy Matusiewicz, RVP, Irvine, CA 800-933-9808	Brion Beetz, RVP, San Ramon, CA 800-274-8491	Tim Jones, RVP, State of Washington 800-462-9277	Jeff Fossier, RVP, Chicago, IL 800-926-5862	Mike Abkowitz Assoc. Mgr. Austin, TX 866-613-6189	Marie Panciocco RVP, New England, 800-596-3384
Muriel Knapp RVP, Orlando, FL 800-360-2684,	David Sharer, RVP, Reston VA 800-879-3133	Joe Dionisi, RVP, Baton Rouge, LA 800-937-7604,	Paul Citron, RVP, Raleigh, NC 888-600-2763	Michael Sole, VP, Eastern Region 800-926-5862	Duane Jeffers, RVP, Pennsylvania 800-222-1567
Vince Camacho RVP, Guam 671-475-8938	Duane Jeffers, RVP, Ohio 800-284-0444	Kris Morton, Assoc. Manager Ohio 800.284.0444 ext. 11	Fred Bender VP, Denver, CO 800-947-4409	Kent Morris, VP, Western Region, Glendale 800-382-8924	Sylvia Hackl Assoc. Mgr. Cheyenne 800.989.9324
Julie Klassen Defined Contribution Specialist Western Region 800.933.9808					Britt Palmer Defined Contribution Specialist Eastern Region 800.537.2033 ext. 72083



Great-West Retirement Services
Government Markets Division


Great-West