

# KENTUCKY PUBLIC EMPLOYEES' DEFERRED COMPENSATION AUTHORITY

## Deemed IRA Program -- Distribution Notice

This notice contains important information you will need before you decide how to receive your benefits in the Kentucky Public Employees' Deferred Compensation Authority Deemed IRA Program.

This notice is provided to you by the Kentucky Public Employees' Deferred Compensation Authority (your "Plan Administrator") because all or part of the payment that you will soon receive from the Kentucky Deemed IRA Program may be eligible for rollover by you or the Authority to a traditional IRA, Roth IRA, or eligible retirement plan. A rollover is a payment by you or the Authority of all or part of your benefit to another plan or IRA that allows you to continue to postpone taxation of that benefit until it is paid to you. Your Plan payment cannot be rolled over to a SIMPLE IRA or a Coverdell Education Savings Account (formerly known as an education IRA). An "eligible retirement plan" includes a plan qualified under Section 401(a) of Internal Revenue Code of 1986 (Title 26 of the U.S. Code), as amended ("Code"), such as a pension plan, profit sharing plan, stock bonus plan, money purchase plan, or 401(k) plan; an annuity plan described under Code Section 403(a); a tax-sheltered annuity described under Code Section 403(b) (a "403(b) plan"); and an eligible plan maintained by a governmental employer described under Code Section 457(b) ("governmental 457 plan").

An eligible employer plan is not legally required to accept a rollover. Before you decide to roll over your payment to another employer plan, you should find out whether the plan accepts rollovers and, if so, the types of distributions it accepts as a rollover. You should also find out about any documents that are required to be completed before the receiving plan will accept a rollover. If an employer plan accepts your rollover, the plan may restrict subsequent distributions of the rollover amount or may require your spouse's consent for any subsequent distribution. A subsequent distribution from the plan that accepts your rollover may also be subject to different tax treatment than distributions from your Deemed IRA Account. Check with the administrator of the plan that is to receive your rollover prior to making the rollover.

If you have additional questions after reading this notice, you can contact our Solutions Center at 1-800-542-2667.

### A. Deemed Traditional IRA.

Distributions. You may withdraw amounts from your Deemed Traditional IRA at any time by total or partial lump sum. The Authority will not make any distribution from your Deemed IRA Account until it has received your (or your beneficiary's) written direction in a form and manner acceptable to the Authority. Distributions from a Deemed Traditional IRA Account are taxed as ordinary taxable income in the taxable year in which distribution is received. Generally, distributions are subject to federal income tax withholding. You may elect not to have withholding apply to your Deemed IRA distribution.

If you make no election, the Kentucky Deemed IRA Program will withhold 10% for federal income tax for non-periodic distributions. If you have made nondeductible contributions to your Deemed IRA Account, a certain portion of your distribution may be nontaxable, as computed and elected by you. The calculation for determining the nontaxable amount is completed by using IRS Form 8606. The Authority does not account for any nondeductible contributions, and therefore on distribution, it is up to **YOU** to report any such return as a nontaxable amount.

Early Withdrawals. If you receive a distribution from your Deemed IRA Account prior to age 59-1/2, a 10% additional tax may be imposed on the amount of taxable distribution. This tax is in addition to regular income tax on the taxable portion of your distribution. To claim any exemption from the 10% tax, you must file IRS Form 5329. Certain exceptions to the 10% additional tax may apply, including distribution on account of:

- (a) death;
- (b) disability;
- (c) payments made as part of a series of substantially equal periodic payments made at least annually over your life (or life expectancy), or over the joint lives (or joint life expectancies) of you and your designated beneficiary;
- (d) payments for medical care to the extent such distributions do not exceed amounts allowable as a deduction under Code Section 213;
- (e) health insurance premiums for unemployed individuals;
- (f) payment of qualified higher education expenses as defined under Code Section 72(t)(7) for you, your spouse, your children or grandchildren;
- (g) payment of qualified first-time home buyer distributions as defined under Code Section 72(t)(8), \$10,000 lifetime limit; and
- (h) distribution of a qualified reservist distribution.

Disability. You are considered disabled if you are 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 a long-continued and indefinite duration. If you have retired due to disability you must provide your disability approval letter from your respective Kentucky State Retirement System.

Age 72. Minimum distributions are required from your Deemed Traditional IRA Account upon your attainment of age 72. The minimum distribution will be an amount calculated in accordance with IRS regulations and payable to you beginning in the year you attain age 72. In general, the amount will be based on your Deemed Traditional IRA Account value divided by your life expectancy based on IRS tables. In addition, minimum required distributions will be made from your Deemed IRA Account in accordance with 401(k) Plan provisions. If a minimum distribution is required from your Deemed IRA Account, KPEDCA will automatically calculate and distribute that amount to you.

If the amount distributed from your Deemed Traditional IRA Account during a taxable year is less than the minimum required during such year, an excise tax, which must be paid by you, is imposed under Code Section 4974, in an amount equal to 50% of the excess of the minimum required to be distributed over the amount actually distributed during the year. If you receive more than the required minimum distribution in any year, you will not receive credit for the additional amount. Distributions after the year you turn age 72 must be made by December 31 of that later year.

Death. Special rules apply in the event of your death depending on whether you die before or after any minimum required distributions have commenced. Your beneficiary will be paid in accordance with applicable 401(k) Plan provisions in the event of your death. Under the 401(k) Plan, payment of your Deemed Traditional IRA Account must be completed (and paid in full to your beneficiary) no later than the December 31 of the year containing the fifth anniversary of your death regardless of your named beneficiary. If a Deemed IRA owner dies after reaching age 72 but before April 1 of the next year, no minimum distribution is required.

**Rollovers.** A rollover is an amount from an eligible retirement plan to another qualifying retirement plan or IRA. The contribution to the second retirement plan is called a “rollover contribution.” You cannot deduct a rollover contribution, but you must report the rollover distribution on your federal income tax return. You are required to make an irrevocable election indicating that the transaction will be treated as a tax-free rollover contribution. These general rules apply to rollovers:

- (a) You may make Direct Rollover, as explained earlier in this Notice.
- (b) You may make Sixty-Day Rollover. The rollover must be completed no later than the 60th day after the day on which you receive distribution. Amounts not rolled over within the 60-day period are treated as a taxable distribution. These amounts are taxable in the year distributed, even if the 60-day period expires in the next year.
- (c) If you make tax-free (60-day indirect) rollover from a traditional IRA, you cannot within a 1-year period make a tax-free rollover of any later distribution from that same IRA. Also, you cannot make tax-free rollover of any amount distributed from the IRA, within the same 1-year period, from the IRA into which you made tax-free rollover. The 1-year period begins on the date you receive the IRA distribution, not on the date you roll it over into an IRA. IRA transfers (from one IRA to another) are not subject to this 1-year waiting period.
- (d) If you inherit a Deemed IRA Account, you may roll over the Deemed IRA Account if you are the surviving spouse. In addition, nonspouse beneficiaries may transfer their Deemed IRA Account to an inherited IRA.
- (e) If you have attained age 72, you must receive minimum required distributions from your Deemed IRA Account, and you may not rollover an amount which is your minimum required distribution.
- (f) You may make partial rollovers of your Deemed IRA Account.

**Availability of Rollovers Into Deemed IRA Account.** You may make a rollover from funds of any of the following into your Deemed IRA Account:

- (i) traditional IRA/SEP (deductible and nondeductible amounts).
- (ii) qualified plan, such as 401(k), profit sharing or other retirement plan tax-qualified under Code Section 401(a) (“Qualified Plan”) (deductible and nondeductible amounts).
- (iii) eligible deferred compensation plan under Code Section 457 which is maintained by a government or state agency (“Government 457 Plan”).
- (iv) tax-sheltered annuity/403(b) (deductible amounts only).

If you rollover after-tax (nondeductible) contributions into your Deemed Traditional IRA, **YOU** are required to keep track of such amounts as required by the IRS. This will enable you to calculate the nontaxable amount of future distributions from your Deemed Traditional IRA. The Authority does not separately account for nondeductible amounts rolled into your Deemed IRA Account.

**Availability of Rollovers From Deemed IRA Account.** You may make a tax-free distribution from your Deemed Traditional IRA Account to any of the following:

- (i) another IRA which you own.
- (ii) Qualified Plan which accepts rollovers.
- (iii) Government 457 Plan which accepts rollovers.
- (iv) tax-sheltered annuity/403(b).

Transfers. A transfer may be made by the account owner, beneficiary or recipient under transfer incident to divorce. A transfer means a direct deposit to your IRA without payment to you or access by you to any funds. Transfers are not taxable or reportable. If you direct distribution to another IRA, the Authority will treat the distribution as a transfer.

Divorce. A Deemed IRA account may be divided and paid out based on a divorce decree or separation agreement. An ex-spouse who is not a Plan participant may not rename the participant's Deemed IRA Account as his or her own; in such case, the ex-spouse must take either direct payment (as taxable distribution to the ex-spouse) or make transfer to a new IRA. The transfer is tax-free.

Except for transfers, all withdrawals from a Deemed Traditional IRA Account will be reported to the IRS by Form 1099-R. This form is mailed in January of the year following the year of distribution. You have sole responsibility for correctly reporting withdrawals on your income tax returns. You should keep proper records of your contributions for reporting income tax.

#### B. Deemed Roth IRA.

Distributions. You may withdraw amounts from your Deemed Roth IRA Account at any time by total or partial lump sum. A distribution from your Deemed Roth Account is not subject to federal income tax if it is a "qualified distribution." You also do not include as taxable income the return of your regular contributions from your Deemed Roth IRA. A qualified distribution is one that is **BOTH**

- (a) made after a five-taxable year period; and
- (b) a distribution --
  - (i) made on or after the date on which you attain age 59-1/2; (ii) made to a beneficiary after your death;
  - (iii) attributable to your disability as defined in Code Section 72(m)(7); or
  - (iv) for qualified first-time home buyer expenses (up to \$10,000 lifetime limit).

For the Kentucky Deemed IRA program the five-taxable year period begins with the first taxable year for which you made a contribution (including rollovers and transfers) to your Kentucky Deemed Roth IRA Account. The authority will report withdrawals from your Kentucky Deemed Roth IRA calculating the 5-year period based solely on the date of contributions to your Kentucky Deemed Roth IRA– not any other Roth IRA which you may own. The five-taxable year period ends on the last day of such fifth taxable year.

Non-qualified distributions are taxable to the extent distribution is attributable to income earned in the Deemed Roth IRA Account. Non-qualified distributions are treated as taken from the non-taxable portion first (your Roth contributions) until aggregate distributions exceed aggregate contributions. In effect, any amount distributed from your Deemed Roth IRA is treated as made first from your contributions, then taxable earnings. It is up to you to report properly the tax effect of your Roth distribution on your federal income tax return.

In addition, the 10% early withdrawal tax under Code Section 72(t) will apply to any taxable distribution, unless an exception is available. Generally, Deemed Roth IRA distributions are subject to the same withholding rules as explained above for traditional IRA's. You are required to file IRS Form 8606 on any distributions from your Deemed Roth IRA Account; please see IRS Publication 590 for more details.

You can withdraw, tax-free, all or part of your Deemed Roth IRA Account if you contribute the amount within 60 days to another Roth IRA. Rollovers from retirement plans other than Roth IRA's are disregarded for purposes of the 1-year waiting period between rollovers. Rollovers from a Roth IRA to an employer retirement plan are not allowed.

Withdrawals by Due Date. If you withdraw Roth contributions (including any earnings on the contributions) by the due date, as extended, of your tax return for the year for which you made the contribution, the contribution is treated as if never made. The withdrawal of your contribution is tax-free, but you must include the earnings on the contributions as taxable income for the year for which you made the contribution.

Age 72 and Death. Unlike the rules mentioned above for Deemed Traditional IRA Accounts, you are not required to begin distributions from your Deemed Roth IRA Account upon your attainment of age 72. Payment of your Deemed Roth IRA Account in the event of your death must be completed (and paid in full to your beneficiary regardless of your named beneficiary) no later than the December 31 of the year containing the fifth anniversary of your death, consistent with the 401(k) Plan.

Transfers. Distributions from one Roth IRA can be transferred tax-free to another Roth IRA, meaning that you may transfer your Deemed Roth IRA Account to another Roth IRA. For more information, see the transfer rules mentioned above pertaining to Deemed Traditional IRA Accounts.

You may also rollover the following amounts into your Deemed Roth IRA Account: Roth IRA and Roth 401(k) contribution account (held in a qualified plan or tax sheltered annuity, TSA). Distributions from tax-qualified retirement plans, TSA's and Section 457 plans may be rolled over directly into your Deemed Roth IRA Account, subject to restrictions that apply to rollovers from a traditional IRA into a Roth IRA. Furthermore, such a rollover is not tax-free.

Except for transfers, all withdrawals from a Deemed Roth IRA Account will be reported to the IRS by Form 1099-R. This form is mailed in January of the year following the year of distribution. You have sole responsibility for correctly reporting withdrawals on your income tax returns. You should keep proper records of your contributions for reporting income tax.

C. Beneficiaries. If you inherit a Deemed IRA, you are called a beneficiary. Beneficiaries of a Deemed Traditional IRA must include as taxable income amounts they receive. If you are a beneficiary because you inherit your deceased spouse's Deemed IRA, you may roll the distribution over into your own IRA by direct rollover or within the 60-day limit, as long as the distribution is not a required minimum distribution. If you inherit a Deemed IRA from someone other than your spouse, you cannot treat the inherited IRA as your own. This means that you cannot make any contributions to the Deemed IRA. However, you can make an IRA tax-free transfer as long as the recipient IRA is set up and maintained in the name of the deceased IRA owner for the benefit of you as beneficiary.

Generally, as beneficiary you will owe income tax on receipt of distributions from a traditional IRA. If you inherit a Deemed Traditional IRA as a nonspouse beneficiary from the IRA owner who had tax basis in the IRA because of nondeductible contributions, that basis remains with the IRA, and you cannot combine that basis with any basis in your own IRA. Roth qualified distributions will be paid tax-free to your beneficiary. If a distribution to a beneficiary is not a Roth qualified distribution, it will generally be taxable to the beneficiary in the same manner as it would have been taxed to the Deemed Roth Account owner if distributed when alive.

D. Conversions. Conversions of Deemed Traditional IRA's to Deemed Roth IRA's may also be processed in the Deemed IRA Program. You should consult your tax advisor as to the advisability of such transactions.

Conversion. On conversion from a Deemed Traditional IRA to a Roth IRA, federal income tax is payable on the converted amount. You may convert amounts from a traditional IRA to a Roth IRA if, for the tax year you make the withdrawal from your Deemed Traditional IRA, the following requirements are met: (1) your modified adjusted gross income is not more than \$100,000; and (2) you are not married filing a separate federal income tax return. The \$100,000 limit applies to the tax year in which funds are paid from the Deemed Traditional IRA, not the year contributed to a Roth IRA. The amount taken from your Traditional IRA and properly (and timely) contributed to your Roth IRA is called a conversion contribution. You cannot convert amounts that must be distributed to you as required minimum distributions. If you inherited a traditional IRA from someone other than your spouse, you cannot convert it to a Roth IRA.

If properly rolled over (converted) to a Roth IRA, the 10% additional tax on early distributions will not apply upon conversion. If within the 5-year period starting with the first day of your tax year in which you convert an amount from a Deemed Traditional IRA to a Deemed Roth IRA, you take a distribution from the Deemed Roth Account, you may have to pay the 10% additional tax on early distributions. A separate 5-year period applies to each conversion. Withholding rules under Code Section 3405 apply to conversions.

Conversion may also be made by direct rollover into a Deemed Roth IRA from an eligible retirement plan, including 401(a) qualified plans, TSA's and governmental 457 plans, as explained above on page 2.

## HOW TO OBTAIN ADDITIONAL INFORMATION

This notice summarizes only the federal (not state or local) tax rules that might apply to your payment. The rules described above are complex and contain many conditions and exceptions that are not included in this notice, and the tax rules are subject to change without subsequent notice to you from the Authority. Therefore, you may want to consult with a professional tax advisor before you take a payment of your benefits from the Deemed IRA Program. Also, you can find more specific information on the tax treatment of payments from qualified employer plans in IRS Publication 575, Pension and Annuity Income, and IRS Publication 590, Individual Retirement Arrangements. These publications are available from your local IRS office, on the IRS's Internet Web Site ([irs.gov](http://irs.gov)) or by calling 1-800-TAX-FORMS.