

## Revenue Ruling 85-62

Individual retirement accounts; excess earnings. Increases in earnings credited to and individual retirement account that are attributable to companion account are treated as contributions to the individual retirement account.

### ISSUE

Are earnings credited to an individual retirement account (IRA) described in section 408(a) of the Internal Revenue Code, which are attributable to a non-IRA companion account maintained at the same financial institution, treated as contributions to the IRA?

### FACTS

On January 3, 1984, A, an unmarried individual, made a \$2,000 contribution for 1984 to A's IRA that was established at M, a qualified financial institution. M offered to credit, on a daily basis, 10 percent annual interest (the current market rate of interest) on A's IRA. M also offered credit, on a daily basis, 18 percent annual interest on A's IRA if an equal amount was deposited by A in a specified companion account at M. On January 3, 1984, A also established the companion account at M with a deposit of \$2,000. No amounts were distributed from the IRA before the due date of A's 1984 federal income tax return.

### LAW AND ANALYSIS

Section 61 of the Code provides that, except as otherwise provided, gross income includes income from whatever source derived, including interest.

Section 219(b) of the Code allows an individual to deduct up to the lesser of 100 percent of compensation or \$2,000 each year for contributions to an IRA.

Section 4973(b) of the Code defines an excess contributions as an amount contributed to an IRA which exceeds the amount allowable as a deduction under section 219. Excess contributions to an IRA are subject to a six percent excise tax under section 4973, unless such excess contributions, and any earnings thereon, are distributed on or before the date prescribed by law (including extensions) for filing the individual's tax return for the year in which the excess contributions were made. Distributions of excess contributions from an IRA after the due date of the return may be includible in gross income and subject to an additional 10 percent tax under section 408(f). Any distribution of earnings attributable to an excess contribution is includible in gross income and will be subject to the additional 10 percent tax if the individual has not attained age 59-1/2 or become disabled (see section 1.408-4(c) of the Income Tax Regulations).

In this case, earnings were credited to the IRA in excess of those which would have been credited to the IRA if A had no other accounts with M. The earnings in excess of those that could be earned on the IRA, if A had not established the companion account, are deemed to be interest on the companion account. These excess earnings are considered to be received by A and includible in A's income when credited to the IRA.

These excess earnings are treated as contributions to the IRA because they are, in effect, earnings attributable to the companion account and merely are credited to the IRA. The excess earnings, when added to the \$2,000 contributed by A to the IRA, result in a contributing more than the maximum amount deductible for 1984. Thus, there are excess contributions. These excess contributions do not cause A's IRA to cease to be an individual retirement account described in section 408(a) of the Code. However, such excess contributions are subject to the annual six percent excise tax under section 4973 and, if distributed, may be subject to the additional 10 percent tax under section 408(f).

## HOLDING

Earnings credited to an IRA, which are attributable to a non-IRA companion account maintained at the same financial institution, are deemed to be interest earned by A on the companion account. When credited to the IRA, these earnings are treated as received by A, includible in A's income, and as contributions to the IRA. This holding is not changed if the companion account is credited with little or no interest or the maximum interest allowable under applicable law and regulations, or if the companion account deposit required is not equal to the IRA Contribution.

It should be noted that both the amount of interest deemed earned and any amount actually earned on the companion account are considered interest income for purposes of section 6049 of the Code. Therefore, reporting on Form 1099-INT is required for the aggregate of both amounts and both amounts are considered payments to which backup withholding may apply under section 3406.