

# Special Tax Notice Regarding Lump Sum Distributions For Distributions Made After January 1, 2002

For distributions made prior to January 1, 2002, refer to earlier notice which can be obtained from the Retirement System

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This notice contains important information needed before you decide how to receive your lump sum distribution payment. In accordance with the requirements of Internal Revenue Code Section 402(f), this notice is being provided to you by the Retirement System because you may be eligible to roll over all or part of the payment that you will soon receive from the Retirement System.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”) has significantly changed the rules which apply to your ability to rollover all or part of the payment that you will soon receive from the Retirement System. These changes include an increase in the type of retirement plans to which you may rollover your lump sum distribution payment. This notice will explain the operation of these new rules and your options.

If you have additional questions after reading this notice, please contact the Retirement System.

## Summary

There are two ways you may be able to receive a lump sum distribution payment that is eligible for rollover:

- (1) certain payments can be made directly to an ELIGIBLE RETIREMENT PLAN that will accept it (**Direct Rollover**), or
- (2) the payment can be **Paid To You**.

The definition of an ELIGIBLE RETIREMENT PLAN, as used in this notice, depends on the payment date of the lump sum distribution payment.

An ELIGIBLE RETIREMENT PLAN is

- (1) A traditional IRA. A traditional IRA does **not** include a Roth IRA, SIMPLE IRA or education IRA.
- (2) Another qualified employer plan under Code Section 401(a) or an annuity plan under Code section 403(a) that accepts your rollover.
- (3) An annuity contract described in Code Section 403(b) that accepts your rollover.
- (4) An eligible deferred compensation plan under Code Section 457(b) that is maintained by a state, political subdivision of a state, or any agency or instrumentality of a state or local governmental entity so long as it agrees to accept your rollover, separately accounting for amounts transferred into such plan from the Retirement System’s plan.

If you choose a **Direct Rollover**

- (1) Your payment will not be taxed in the current year and no income tax will be withheld.
- (2) Your payment will be made directly to an ELIGIBLE RETIREMENT PLAN.



- (3) The taxable portion of your payment will be taxed later when you take it out of the ELIGIBLE RETIREMENT PLAN.

If you choose to have a lump sum distribution payment that is eligible for rollover **Paid To You**

- (1) You will receive only 80% of the taxable portion of the distribution. The Retirement System is required to withhold the remaining 20% of the taxable portion of the payment to send it to the IRS as income tax withholding, which will be credited against your taxes.
- (2) Unless rolled over, the taxable portion of your payment will be taxed in the current year. Under limited circumstances, you may be able to use special tax rules that could reduce your tax liability. However, if you receive the payment before age 59½, you also may have to pay an additional 10% tax penalty.
- (3) You can roll over the payment by paying it to an ELIGIBLE RETIREMENT PLAN within 60 days after you receive the payment. The amount rolled over will not be taxed until you take it out of the ELIGIBLE RETIREMENT PLAN.

If, after you receive the lump sum distribution by check, you want to roll over 100% of the taxable portion of the distribution to an ELIGIBLE RETIREMENT PLAN, you must add an amount equal to the 20% that was withheld. If you roll over only the 80% that you received, you will be taxed on the remaining 20% that was withheld and that is not rolled over.

## I. Payments That Can And Cannot Be Rolled Over

Payments from the Retirement System may be “eligible rollover distributions,” meaning that they can be rolled over to an ELIGIBLE RETIREMENT PLAN. The Retirement System will be able to tell you what portion of your payment is an eligible rollover distribution. The definition of an eligible rollover distribution has been changed by EGTRRA.

The following types of payments **cannot** be rolled over:

The non-taxable portion of a lump sum distribution payment which is paid on or after January 1, 2002 may be rolled over to (1) a traditional IRA, or (2) a qualified defined contribution plan, if it is made by a **Direct Rollover** and if the defined contribution plan agrees to separately account for amounts so transferred, including separately accounting for the non-taxable portion of the payment and the taxable portion of the payment. If the after-tax contributions are paid to you first, you cannot roll them over later to a qualified defined contribution plan. However, they could be indirectly rolled over to a traditional IRA (see Section III, “Payment Paid to You”).

**Payments Spread over Long Periods** You cannot roll over a payment if it is part of a series of equal (or almost equal) payments that are made at least once a year and that will last for:

- (1) your lifetime (or your life expectancy);
- (2) your lifetime and your beneficiary’s lifetime (or life expectancies); or
- (3) a period of ten years or more.

**Required Minimum Payments** Upon reaching age 70½ or retirement, whichever is later, a certain portion of your payment cannot be rolled over because it is a “required minimum payment” that must be paid to you.

## II. Direct Rollover

A **Direct Rollover** is a direct payment of the amount of your lump sum distribution payment to an ELIGIBLE RETIREMENT PLAN. You can choose a **Direct Rollover** of all or any portion of your payment that is an eligible rollover distribution, as described in Part I above. You are not taxed on any portion of your payment for which you choose a **Direct Rollover** until you later take it out of the ELIGIBLE RETIREMENT PLAN. In addition, no income tax withholding is required for any portion of your lump sum distribution payment for which you choose a **Direct Rollover**.

**Direct Rollover to a Traditional IRA** You can open a traditional IRA to receive the direct rollover. If you choose to have your payment made directly to a traditional IRA, contact an IRA sponsor (usually a financial institution) to find out how to have your payment made in a direct rollover to a traditional IRA at that institution. If you are unsure of how to invest your money, you can temporarily establish a traditional IRA to receive the payment. However, in choosing a traditional IRA, you may wish to consider whether the traditional IRA you choose will allow you to move all or a part of your payment to another traditional IRA at a later date, without penalties or other limitations. See IRS Publication 590, Individual Retirement Arrangements, for more information on traditional IRAs (including limits on how often you can roll over between IRAs).

**Direct Rollover to a Plan** If you are employed by a new employer that has an ELIGIBLE RETIREMENT PLAN, and you want a direct rollover to that plan, ask the Plan Administrator of that plan whether it will accept your rollover. An ELIGIBLE RETIREMENT PLAN that is not a traditional IRA is not legally required to accept a rollover and may choose to accept only certain types of funds as rollovers. If your new employer's plan does not accept a rollover, you can choose a **Direct Rollover to a Traditional IRA**. If the employer plan accepts your rollover, the plan may restrict subsequent distributions of the rollover amount, or may require spousal consent to any subsequent distribution. You should check with the Plan Administrator before making your decision.

## III. Payment Paid To You

If your payment can be rolled over under Part I above and the payment is made directly to you by check, it is subject to 20% federal income tax withholding. The payment is taxed in the year you receive it unless, within 60 days, you roll it over to an ELIGIBLE RETIREMENT PLAN. If you do not roll it over, special tax rules may apply. For lump sum distribution payments made **ON** or **AFTER** January 1, 2002, the IRS may waive the 60-day requirement in certain circumstances, as explained below.

### Income Tax Withholding

**Mandatory Withholding** If any portion of your payment can be rolled over under Part I above and you do not elect to make a **Direct Rollover**, the Retirement System is required by law to withhold 20% of that amount. This amount is sent to the IRS as income tax withholding. For example, if you can roll over a payment of \$10,000, only \$8,000 will be paid to you because the Retirement System must withhold \$2,000 as income tax. However, when you prepare your income tax return for the year, you must report the full \$10,000 as a payment from the Retirement System. You must report the \$2,000 as tax withheld, and it will be credited against any income tax you owe for the year.

**Voluntary Withholding** If any portion of your payment is taxable but cannot be rolled over under Part I above, the mandatory withholding rules described above do not apply. In this case, you may elect not to have withholding apply to that portion. To elect out of withholding, ask the Retirement System for the election form and related information.

**Sixty-Day Rollover Option** If you receive a payment that can be rolled over under Part I above, you can still decide to roll over all or part of it to an ELIGIBLE RETIREMENT PLAN. If you decide to roll over, you must contribute the amount of the payment you received to an ELIGIBLE RETIREMENT PLAN within 60 days after you receive the payment. The portion of your payment that is rolled over will not be taxed until you take it out of the ELIGIBLE RETIREMENT PLAN.

You can roll over up to 100% of your payment that can be rolled over under Part I above, including an amount equal to the 20% that was withheld. If you choose to roll over 100%, you must find other money within the 60-day period to contribute to the ELIGIBLE RETIREMENT PLAN, to replace the 20% that was withheld. On the other hand, if you roll over only the 80% that you received, you will be taxed on the 20% that was withheld.

Example: The portion of your payment that can be rolled over under Part I above is \$10,000, and you choose to have it paid to you. You will receive \$8,000, and \$2,000 will be sent to the IRS as income tax withholding. Within 60 days after receiving the \$8,000, you may roll over the entire \$10,000 to an ELIGIBLE RETIREMENT PLAN. To do this, you roll over the \$8,000 you received from the Retirement System and you will have to find \$2,000 from other sources (your savings, a loan, etc.). In this case, the entire \$10,000 is not taxed until you take it out of the ELIGIBLE RETIREMENT PLAN. If you roll over the entire \$10,000, when you file your income tax return you may get a refund of part or all of the \$2,000 withheld.

If, on the other hand, you roll over only \$8,000, the \$2,000 you did not roll over is taxed in the year it was withheld. When you file your income tax return you may get a refund of part of the \$2,000 withheld. (However, any refund is likely to be larger if you roll over the entire \$10,000.)

The IRS is permitted to waive the 60-day requirement if the failure to do so would be against equity or good conscience. Examples of such waivers may include cases of casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement (examples include, but may not be limited to, death, disability, hospitalization, incarceration, restrictions imposed by a foreign country, or postal error). You must apply to the IRS for this waiver.

**Additional 10% Tax If You Are under Age 59½** If you receive a payment before you reach age 59½ and you do not roll it over, then, in addition to the regular income tax, you may have to pay an extra tax equal to 10% of the taxable portion of the payment. The additional 10% tax generally does not apply to

- (1) payments that are paid after you separate from service with your employer during or after the year you reach age 55,
- (2) payments that are paid because you retire due to disability,
- (3) payments that are paid as equal (or almost equal) payments over your life or life expectancy (or your and your beneficiary's lives or life expectancies),
- (4) payments that are paid directly to the government to satisfy a federal tax levy,
- (5) payments that are paid to an alternate payee under a qualified domestic relations order, or
- (6) payments that do not exceed the amount of your deductible medical expenses.

See IRS Form 5329 for more information on the additional 10% tax penalty.

**Special Tax Treatment If You Were Born Before January 1, 1936** If you receive a payment that can be rolled over under Part I and is not rolled over to an ELIGIBLE RETIREMENT PLAN, the payment will be taxed in the year you receive it. Special tax treatment for lump sum distributions that may be available to you is described below.

**Ten-Year Averaging** If you receive a lump sum distribution and you were born before January 1, 1936, you can make a one-time election to figure the tax on the payment by using “10-year averaging” (using 1986 tax rates). Ten-year averaging often reduces the tax you owe.

**Capital Gain Treatment** If you receive a lump sum distribution and you were born before January 1, 1936 and if you were a participant in the Retirement System before 1974, you may elect to have the part of your payment that is attributable to your pre-1974 participation in the Retirement System taxed as long-term capital gain at a rate of 20%.

There are other limits on the special tax treatment for lump sum distributions. For example, you can generally elect this special tax treatment only once in your lifetime, and the election applies to all lump sum distributions that you receive in that same year. If you have previously rolled over a distribution from the Retirement System (or certain other similar plans of the employer), you cannot use this special averaging treatment for later payments from the Retirement System. If you roll over your payment to a traditional IRA, you will not be able to use special tax treatment for later payments from the traditional IRA. Also, if you roll over only a portion of your payment to a traditional IRA, this special tax treatment is not available for the rest of the payment. See IRS Form 4972 for additional information on lump sum distributions and how you elect the special tax treatment.

**Important notice for distributions ON or AFTER January 1, 2002** As explained in this notice, EGTRRA creates new rollover options. However, a distribution from a qualified plan, like your lump sum distribution payment, is not eligible for capital gains or averaging treatment if there was a rollover to the plan that would not have been permitted under the law in effect before January 1, 2002. Thus, in order to preserve capital gains and averaging treatment (if available) for a lump sum distribution payment that is rolled over, the rollover would have to be made to a “conduit IRA” (i.e., a traditional IRA which only includes the lump sum distribution payment), and then rolled back into a qualified plan.

#### IV. Surviving Spouses, Alternate Payees, And Other Beneficiaries

In general, the rules summarized above that apply to payments to employees also apply to payments to surviving spouses of employees and to spouses or former spouses who are “alternate payees.” You are an alternate payee if your interest in the Retirement System results from a domestic relations order, which is an order issued by a court, usually in connection with a divorce or legal separation. Some of the rules summarized above also apply to a deceased employee’s beneficiary who is not a spouse. However, there are some exceptions for payments to surviving spouses, alternate payees, and other beneficiaries that should be mentioned.

If you are a surviving spouse, you have the same choices as the employee described in Parts II and III above. Thus, you may choose to have an eligible rollover distribution, as described in Part I above, paid in a **Direct Rollover** to an ELIGIBLE RETIREMENT PLAN or paid to you. If you have the payment paid to you, you can keep it or roll it over yourself to an ELIGIBLE RETIREMENT PLAN in the same manner as the employee. If you are an alternate payee, you continue to have the same choices as the employee.

If you are a beneficiary other than the surviving spouse, you cannot choose a direct rollover, and you cannot roll over the payment yourself.

If you are a surviving spouse, an alternate payee, or another beneficiary, your payment is generally not subject to the additional 10% tax penalty described in section III above, even if you are younger than age 59½.

If you are a surviving spouse, an alternate payee, or another beneficiary, you may be able to use the special tax treatment for lump sum distributions, as described in Part III above. If you receive a payment because of the employee's death, you may be able to treat the payment as a lump sum distribution if the employee met the appropriate age requirements, whether or not the employee had 5 years of participation in the Retirement System.

## 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. Therefore, you may want to consult with a professional tax advisor before you take a payment of your benefits from the Retirement System. Also, you can find more specific information on the tax treatment of payments from qualified retirement 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 at [www.irs.gov](http://www.irs.gov), or by calling 1-800-TAX-FORMS.