THE SCHOOL EMPLOYEES RETIREMENT SYSTEM OF OHIO

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Special Tax Notice Regarding The Taxable Portion Of Your Lump Sum Payment

IMPORTANT

THIS NOTICE CONTAINS IMPORTANT INFORMATION YOU WILL NEED BEFORE YOU DECIDE HOW TO RECEIVE YOUR LUMP SUM PAYMENT. IT IS PROVIDED TO YOU BY THE SCHOOL EMPLOYEES RETIREMENT SYSTEM BECAUSE ALL OR PART OF THE PAYMENT THAT YOU WILL SOON RECEIVE MAY BE ELIGIBLE FOR ROLLOVER BY YOU.

For payments that are made on or after January 1, 2002, 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 receive from SERS, including an increase in the type of retirement plans to which you may roll over your payment.

SUMMARY

There are two ways you can receive a payment that is eligible for rollover:

(1) the payment can be made directly to an ELIGIBLE RETIREMENT PLAN that will accept it ("DIRECT ROLLOVER"), or

(2) the payment can be PAID TO YOU.

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) which is maintained by a state, political subdivision of a state, or any agency or instrumentality of a state or local governmental entity and which agrees to accept your rollover and separately account for amounts transferred into such plan from SERS.

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 payment that is eligible for rollover *PAID TO YOU*

(1) You will receive only 80% of the taxable portion of the payment, because SERS is required to withhold 20% of the payment and send it to the IRS as income tax withholding to be credited against your taxes.

(2) The taxable portion of your payment will be taxed in the current year unless you roll it over. Under limited circumstances, you may be able to use special tax rules that could reduce the tax you owe. However, if you receive the payment before age 59½, you also may have to pay an additional 10% tax.

(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 you want to roll over 100% of the payment to an ELIGIBLE RETIREMENT PLAN, you must find other money to replace the 20% that was withheld. If you roll over only the 80% that you received, you will be taxed on the 20% that was withheld and that is not rolled over.

PAYMENTS THAT CAN AND CANNOT BE ROLLED OVER

Payments from SERS may be "eligible rollover distributions." This means that they can be rolled over to an ELIGIBLE RETIREMENT PLAN.

Non-taxable Payments. If you have made "after-tax" contributions to SERS, these contributions will not be taxed when they are paid to you. (After-tax employee contributions generally are contributions you made from your own pay that were already taxed.) SERS will tell you how much of your payment is the taxable portion and how much is the after-tax employee contribution portion.

However, the after-tax contributions may be rolled over to:

(1) A Traditional IRA - You can roll over your after-tax contributions to a traditional IRA either directly or indirectly. If you do this, it is your responsibility to keep track of, and report to the IRA on the applicable forms, the amount of these after-tax contributions. This will enable the non-taxable amount of future distributions from the IRA to be determined. Once you roll over your after-tax contributions to a traditional IRA, those amounts CANNOT later be rolled over to an employer plan.

(2) An Employer Plan - The employer must provide separate accounting for amounts rolled over, including separate accounting for the after-tax contributions and earnings on those contributions. If you want to roll over your after-tax contributions to an employer plan, you CANNOT have the contributions paid to you first. Also, you CANNOT roll over after-tax contributions to a traditional RIA and then roll over that amount into an employer plan.

Payments Spread Over Long Periods. You cannot roll over a payment if it is a series of equal (or almost equal) payments that are made at least once a year and that will last for: your lifetime; your lifetime and your beneficiarie’s lifetimes; or a period of ten years or more.

Required Minimum Payments. Beginning when you reach age 70-1/2, a certain portion of your payment cannot be rolled over because it is a “required minimum payment” that must be paid to you.

DIRECT ROLLOVER

A DIRECT ROLLOVER is a direct payment to an ELIGIBLE RETIREMENT PLAN. You can choose a DIRECT ROLLOVER of all or any portion of your SERS payment that is an eligible rollover distribution, as described 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 taxable portion of your 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. Even 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.

PAYMENT PAID TO YOU

If your payment can be rolled over above and the payment of $200 or more is made to you directly; 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. 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 and you do not elect to make a DIRECT ROLLOVER, SERS is required by law to withhold 20% of the taxable 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 SERS 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 SERS. You must report the $2,000 as tax withheld, and it will be credited against any income tax you owe for the year.

Sixty-Day Rollover Option. If you receive a payment that can be rolled over, 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 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 SERS, 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.
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> 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 lump sum distribution 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 as equal (or almost equal) payments over your life (or you and your beneficiary's lives or life expectancies), (3) payments that do not exceed the amount of your deductible medical expenses, (4) payments that are paid directly to the government to satisfy a federal tax levy, or (5) payments that are paid to an alternate payee under a division of property order. See IRS Form 5329 for more information on the additional 10% tax.

Special Tax Treatment If You Were Born Before January 1, 1936:

If you receive a payment that can be rolled over and you do not roll it over to an ELIGIBLE RETIREMENT PLAN, the payment will be taxed in the year you receive it. However, if the payment qualifies as a "lump sum distribution," it may be eligible for special tax treatment. A lump sum distribution is a payment, within one year, of your entire balance under SERS that is payable to you after you have reached age 59½ or because you have separated from service with your employer. For a payment to be treated as a lump sum distribution, you must have been a participant in SERS for at least five years before the year in which you received the distribution. The 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.

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. You may not elect this special tax treatment if you rolled amounts into SERS' plan from a 403(b) tax-sheltered annuity or from an IRA not originally attributable to a qualified employer plan. If you have previously rolled over a distribution from SERS, you cannot use this special averaging treatment for later payments from SERS. If you roll over your payment to a traditional IRA, governmental 457 plan or 403(b) tax-sheltered annuity, you will not be able to use special tax treatment for later payments from that IRA, plan, or annuity. Also, if you roll over only a portion of your payment to a traditional IRA, governmental 457 plan or 403(b) tax-sheltered annuity, 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.

SURVIVING SPOUSES, ALTERNATE PAYEES, AND OTHER BENEFICIARIES

In general, the rules summarized above that apply to payments to members also apply to payments to surviving spouses of members and to spouses or former spouses who are "alternate payees". You are an alternate payee if your interest is a result of a "division of property order", which is an order issued by a court, usually in connection with a divorce or legal separation.

If you are a surviving spouse or alternate payee, you have the same choices as the member described above. Thus, you may choose to have an eligible rollover distribution 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 member.

If you are a beneficiary other than the surviving spouse or an alternate payee, you cannot choose a direct rollover, and you cannot roll over the payment yourself. 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, simply check the appropriate box on the application. Otherwise, 10% will be withheld from the taxable portion of your payment.

If you are a surviving spouse, an alternate payee, or another beneficiary, your payment is generally not subject to the additional 10% tax even if you are younger than age 59½. You may be able to use the special tax treatment for lump sum distributions, as described above. If you receive a payment because of the member's death, you may be able to treat the payment as a lump sum distribution if the member met the appropriate age requirements, whether or not the member had five years of participation in SERS.

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. <u>Therefore, you may want to consult with a professional tax advisor before you apply for a payment from SERS.</u> 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 <u>www.irs.gov</u>, or by calling 1-800-TAX-FORMS.