

FAQ's About Retirement Planning

Whether you are about to change careers or retire, you have made an important decision for your future—one that may be filled with exciting plans, hopes, and opportunities. As you prepare for this change, you have one more important decision to make: what you should do with the retirement investments that have been accumulating on your behalf.

You probably have many questions about your retirement plan distributions and the available alternatives. This section provides you with some answers and important information concerning taxes, retirement planning, and investments. When reviewing this information, remember that it is important to consider how new and existing tax laws may apply to your particular situation.

One law in particular may have a major impact on your decisions: the Unemployment Compensation Amendments Act of 1992. While its primary purpose is to generate revenue for unemployment benefits, this law made important changes in the way retirement plan assets are rolled over to an individual retirement account or another employer's plan.

Specifically, employees have a "direct rollover" option, under which most types of plan distributions may be paid directly to the IRA or other eligible retirement plan of the employee's choice. In addition, the law discourages employees from having most types of plan distributions paid directly to them by imposing mandatory 20% withholding on these amounts.

The first part of this section examines the major issues concerning the Unemployment Compensation Amendments Act—and, more specifically, how this law and its 20% withholding requirement affect your plan distributions.

THE LAW AND ITS 20% WITHHOLDING REQUIREMENT

What are the main provisions of the Unemployment Compensation Amendments Act of 1992?

- Expands the types of employer-sponsored plan distributions that may be rolled over to a traditional IRA or other eligible retirement plan on a tax-free basis.
- Requires all tax-qualified plans and 403(b) arrangements to offer participants a "direct" rollover option through which an eligible rollover distribution may be paid directly to a traditional IRA or other eligible retirement plan.
- Imposes mandatory 20% withholding on any eligible rollover distribution that an individual does not elect to transfer directly to a traditional IRA or other eligible retirement plan.
- Requires plan administrators to provide participants with a written explanation of the direct rollover option and the 20% withholding requirement.

What distributions are affected?

The direct rollover and 20% withholding requirements generally apply to all eligible rollover distributions made after December 31, 1992. This includes any distribution made after 1992 as the result of an event that occurred prior to January 1, 1993 (such as an employee's separation from service before 1993) and any distributions made after 1992 that are a part of a series of payments begun before January 1, 1993.

What is meant by the "20% withholding requirement"?

When an eligible rollover distribution from your employer's plan is paid to you—rather than to the trustee of a traditional IRA or other eligible retirement plan as a direct rollover—the plan is required by law to withhold 20% of that amount. This amount is sent to the Internal Revenue Service as federal income tax withholding.

For instance, assume that your eligible rollover distribution is \$10,000. Only \$8,000 will be paid to you, because the plan must withhold \$2,000 as income tax. However, when you prepare your federal income tax return for the year, you will report the full \$10,000 as a payment from the plan. You will report the \$2,000 as tax withheld, and it will be credited against any income tax you owe for the year. Note that you will owe ordinary income taxes on \$10,000, less any amount you roll over within 60 days. A 10% federal excise tax may also apply.

What types of distributions are subject to the 20% withholding requirement?

Any distribution from a qualified retirement plan or a 403(b) arrangement that is eligible to be rolled over but is not paid directly to a traditional IRA or other eligible retirement plan is subject to 20% federal income tax withholding.

Are there any exceptions to the 20% withholding requirement?

Yes. The following types of distributions are not eligible for a tax-free rollover and therefore are exempt from the withholding requirement:

- Any plan distribution that is part of a series of substantially equal periodic payments made over your life (or life expectancy), the joint lives (or joint life and last survivor expectancy) of you and your designated beneficiary, or a specified period of 10 years or more.
- Any portion of a distribution that represents a required minimum distribution made after you attain age 70-1/2.
- Any nontaxable portion of a distribution that represents a return of your after-tax contributions.

In addition, the IRS has ruled that eligible rollover distributions of less than \$200 may be excluded at the payor's discretion from the direct rollover and 20% withholding requirements. Note, too, that distributions due to the death of the plan holder are not subject to 20% withholding.

Are distributions from an IRA subject to 20% withholding?

No. The 20% withholding requirements do not apply to distributions from IRAs. However, if you receive a distribution from an IRA before you attain age 59-1/2, you may be subject to the 10% excise tax for early withdrawals.

ROLLING OVER YOUR PLAN DISTRIBUTION

What is a "direct" rollover? How does it differ from a "standard" rollover and an asset transfer?

A direct rollover is the payment of your plan distribution directly to a traditional IRA or other eligible retirement plan of your choice. Your direct rollover distribution check may—at your employer's discretion—be given to you or sent directly to the trustee of your new IRA or plan. In all instances, however, the direct rollover check must be made payable to the trustee of your new IRA or plan.

In a standard rollover, your plan distribution is paid to you (i.e., the check is made payable to you) and you make your own arrangements to roll over the assets to an IRA or other plan.

An asset transfer is the movement of retirement assets between similar plans. This differs from a direct rollover, which is the movement of retirement assets from a qualified plan or 403(b) arrangement to a traditional IRA or other eligible plan. With an asset transfer, no tax forms are generated by either the paying or the receiving custodian. Just as with a standard rollover, a direct rollover will be treated as a distribution and a subsequent rollover contribution. As a result, the paying custodian will report the distribution on IRS Form 1099-R. In the case of a rollover to an IRA, IRS Form 5498 is issued by the receiving institution; there is no corresponding tax form issued in the case of a rollover into a new qualified plan or 403(b)(7) plan.

What are the advantages of a direct rollover to a traditional IRA or other eligible plan?

First, you avoid the 20% federal income tax withholding requirement. Second, with a direct rollover of your distribution to a traditional IRA, you defer paying any current-year taxes on your plan distribution.

What's more, when you make an IRA rollover, any earnings on your retirement assets will continue to grow on a tax-deferred basis, just as they did in your employer's plan. Thus, by making a direct rollover to a traditional IRA, you are provided a double tax benefit:

- You defer the current taxation of your retirement plan distribution.
- You defer the taxation of future earnings on your retirement plan assets until you start to withdraw these amounts from your IRA.
- Over time, the tax-deferred accumulation of your retirement plan assets in your IRA should have a dramatic effect on your total retirement savings.

MAKING YOUR DECISION

How can I initiate a direct rollover from my current retirement plan to a traditional IRA or another eligible retirement plan?

As a first step, it is up to you to select the traditional IRA or other eligible retirement plan to which your direct rollover will be paid. You should then check with the sponsor of your chosen traditional IRA or plan to find out how the direct rollover payment should be made, and what special forms must be completed. Also, if you intend to have your direct rollover paid to another eligible retirement plan, you should confirm that the plan does, in fact, accept direct rollovers. It is important, too, that you ask your benefits office for copies of its direct rollover procedures and forms.

Can I delay my decision?

If you are not yet ready to choose a recipient financial institution for your direct rollover, you may elect to have your plan distribution (less the 20% withholding requirement) paid to you. Any portion of the distribution that you do not roll over to a traditional IRA or an eligible retirement plan within 60 days will be taxable to you as ordinary income in the year of receipt. And, in general, if you are under age 59-1/2, you may also be subject to a 10% federal excise tax. Therefore, if you are not ready to make a decision, you should check to see whether you are permitted to keep your assets in your employer's plan for the time being.

What happens if I roll over my distribution within the 60-day rollover period?

To roll over the entire amount of the distribution, you can make up the 20% that was withheld with other money. The amount withheld will then be credited against any income tax owed.

If you elect not to make up the 20% that was withheld and roll over only the amount you actually received (the total distribution less the 20% withheld), the portion withheld will be treated as a taxable distribution to you. In general, if you are under age 59-1/2, you may also be subject to a 10% additional federal excise tax on this amount, in addition to ordinary income taxes.

Can I split my distribution (i.e., roll over a portion to a traditional IRA or an eligible retirement plan and keep the remainder as a taxable distribution)?

Yes. According to the rules, you may split an eligible rollover distribution by having a portion paid as a direct rollover to a traditional IRA or eligible retirement plan and receiving the remaining portion as a taxable distribution (which is then subject to 20% withholding). Your employer, however, is not required to permit a split if the amount that is paid as a direct rollover is \$500 or less.

Can I roll over my distribution to more than one traditional IRA or eligible retirement plan?

While you have the option of selecting any traditional IRA or eligible retirement plan to receive your direct rollover, your employer is not required to allow you to split up your rollover among two or more retirement arrangements.

Can I roll over my distribution to an existing traditional IRA?

Yes. However, if you wish to preserve your right to roll over your distribution into the eligible retirement plan of a future employer, you should maintain a separate IRA (known as a "conduit" IRA) for these assets. The IRS insists that, under these circumstances, you do not mix these assets with an existing IRA or add future contributions.

If you do not intend to transfer your plan distribution to a new employer's plan, even at a later date, you may commingle these assets with any other traditional IRAs you currently have (provided that these existing IRAs have also not originated from an employer plan or that you have no intention of transferring them to a future employer's plan). The major benefit of commingling IRAs whenever possible is that you can consolidate your holdings and thereby reduce the number of IRA custodial fees you pay each year.

Can I roll over company stock certificates or property, such as real estate or limited partnerships, that I receive from an employer-sponsored plan?

Company stock and property are treated differently. First, you must determine if your company stock or property is eligible to roll over. Your plan administrator can assist you if you are unsure. The portions of the distribution that are eligible may be directly rolled over to a traditional IRA to avoid the 20% federal income tax withholding.

If you choose to take a distribution, and the distribution consists only of company stock, it will not be subject to the 20% federal income tax withholding. This applies whether or not you roll over the assets to a traditional IRA within 60 days.

Eligible distributions containing property in addition to company stock will be subject to the 20% withholding requirements. If there is not sufficient cash included in the distribution to satisfy the withholding obligation, the plan administrator must either sell the property or obtain cash from you in an amount sufficient to cover the withholding.

If you want to roll over the company stock you hold in your retirement plan, you must establish a self-directed traditional IRA. This is an IRA held in a brokerage account.

PENALTIES, REPORTING, AND ADDITIONAL INFORMATION

Am I subject to any other penalties?

Generally, distributions or withdrawals you receive from your employer's plan prior to age 59-1/2 for reasons other than your disability will be subject to an additional federal excise tax of 10%. This 10% excise tax is applied to the taxable amount of your distribution and is in addition to the ordinary income tax you pay on your distribution. The 10% excise tax will not apply, however, to:

- Distributions received if you separate from service with your employer after you have attained age 55.
- Any distribution, to the extent that the amount of the distribution does not exceed the amount of medical expenses that you may deduct in the taxable year of the distribution (i.e., generally medical expenses are deductible to the extent they exceed 7.5% of your adjusted gross income and are not reimbursed).
- Distributions that are part of a series of substantial equal periodic payments made for your life or life expectancy, the lives or life expectancies of you and your beneficiary, or a specified period of ten or more years.

For tax purposes, how do I report a direct rollover?

You simply report the IRA rollover of your distribution on your individual income tax return—Form 1040. Specifically, you report on your return the taxable amount of your plan distribution as reported to you on the Form 1099-R you received by January 31 in the year following your distribution. Then you report as ordinary income any amount of the distribution you did not roll over to the IRA. In the case of a standard rollover, if you rolled over the entire taxable amount of your distribution, you should report the 20% withheld as tax withheld and it will be credited against any income tax you owe for the year.

Where can I find more information about direct rollovers and plan distributions?

Before your plan distribution is paid, your benefits office will provide a written explanation of the special tax rules of which you should be aware.

You will also find information about the tax treatment of payments from qualified plans in IRS Publication 575, *Pension and Annuity Income*, and IRS Publication 590, *Individual Retirement Arrangements*. Both are available from your local IRS office or by calling 1-800-TAX-FORM.

SUMMARY

If you choose a direct rollover:

- Your payment will not be taxed in the current year and no income tax will be withheld.
- Your payment will be made directly to your traditional IRA or, if you choose, to another employer plan that accepts your rollover.
- Your payment will be taxed later when you withdraw it from your traditional IRA or the employer plan.

If you choose to have your plan distribution paid to you:

- You will receive only 80% of the payment—20% will be withheld by the plan administrator as income tax withholding to be credited against your taxes.
- Your payment will be taxed in the current year unless it is rolled over. If you receive the payment before you reach age 59-1/2, you may also be required to pay an additional 10% federal excise tax.
- Within 60 days, you can roll over the payment to an IRA or to another employer plan that accepts your rollover. The amount you roll over will not be taxed until you take it out of the IRA or employer plan.
- If you wish to roll over 100% of the payment to a traditional IRA or employer 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 not rolled over.

For a more detailed explanation of the required minimum distribution rules, refer to IRS Publication 590.