

Tax Considerations for Rollovers

2011



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This notice summarizes the federal tax rules that may apply to your CalSTRS benefit payment and provides limited information on California state tax rules. The rules are complex and contain many conditions and exceptions that are not included in this booklet. Before you take a CalSTRS benefit payment, consult the Internal Revenue Service, the California Franchise Tax Board or a professional tax adviser. You can find more information in IRS Publication 575, *Pension and Annuity Income*, and IRS Publication 590, *Individual Retirement Arrangements*, available at irs.gov or by calling 800-TAX-FORM (800-829-3676).



Introduction

You are receiving this notice because all or a portion of your CalSTRS Defined Benefit, Defined Benefit Supplement or Cash Balance payment is eligible to be rolled over to a qualified IRA or an eligible employer plan. This notice is intended to help you decide whether to do such a rollover.

Rules that apply to most CalSTRS benefit payments are described in the “General Information About Rollovers” section. Special rules that only apply in certain circumstances are described in the “Special Rules and Options” section.

Certain California tax information also is included. In general, California law follows the Internal Revenue Code. However, there are continuing differences between California and federal law. For additional information, visit ftb.ca.gov or call 800-852-5711.

30-Day Notice Period and Your Right to Waive

Generally, CalSTRS cannot make a direct rollover or a payment to you until at least 30 days after you receive the *Special Tax Notice: Your Rollover Options*. After receiving the notice, which is part of the *Service Retirement, Disability Benefits, Refund and Cash Balance* applications, you have at least 30 days to consider whether or not to have your distribution directly rolled over. If you do not wish to wait until this 30-day notice period ends before your payment is processed, you may waive the notice period by requesting a distribution. Your distribution then will be processed in accordance with your election as soon as practical after CalSTRS receives it.

General Information About Rollovers

What Is a Rollover?

A rollover is a distribution of all or part of your payment from a qualified retirement plan, such as CalSTRS Defined Benefit, Defined Benefit Supplement and Cash Balance Benefit programs, to a qualified IRA or another eligible employer plan. Depending on the type of distribution, you may incur taxes or be required to fulfill certain conditions.

What Is a Qualified IRA?

An IRA is an individual retirement arrangement. A qualified IRA is a personal savings plan that gives tax advantages for setting aside money for retirement. You may roll over your CalSTRS payments to a Traditional or Roth IRA. Your CalSTRS payment cannot be rolled over to a SIMPLE IRA or a Coverdell Education Savings Account (an education IRA).

What Is an Eligible Employer Plan?

An eligible employer plan is a plan qualified under the Internal Revenue Code, including sections:

- 401(a): defined benefit, profit-sharing, stock bonus and money purchase plans
- 401(k): profit-sharing, stock bonus and money purchase plans that include qualified cash or deferred compensation
- 403(a): annuity plans
- 403(b): tax-sheltered annuity plans
- 457(b): governmental employer plans

An eligible employer plan is not legally required to accept a rollover. Before you decide to roll over your payment to another employer plan:

- Find out if the plan accepts rollovers and, if so, the types of distributions it accepts as a rollover.
- Ask if any documents are required to be completed before the plan will accept a rollover.

What Payments Can Be Rolled Over?

CalSTRS payments that are “eligible rollover distributions” can be rolled over to a qualified IRA or an eligible employer plan that accepts rollovers. CalSTRS will tell you what, if any, portion of your payment is not an eligible rollover distribution. (See also What Payments Cannot Be Rolled Over, page 5.)

After-Tax Contributions

A plan that accepts rollovers may not accept certain types of distributions such as those from after-tax contributions. If this is the case and your distribution includes after-tax contributions, you may decide to roll over your entire distribution to an IRA, or split your rollover between an employer plan and an IRA. (See also page 9.)

The following rules apply to rollovers of after-tax contributions:

Rollovers Into a Traditional IRA. You can roll over your after-tax contributions to a Traditional IRA as a direct rollover or a 60-day rollover (see page 6).

CalSTRS will tell you the amount of your payment that is the taxable portion and the amount that is the after-tax portion.

If you roll over after-tax contributions to a Traditional IRA, you are responsible for keeping track of the after-tax contributions and reporting them on your tax return. By doing so, you can determine the nontaxable amount of future distributions from your Traditional IRA.

Once you roll over your after-tax contributions to a Traditional IRA, they cannot be rolled over later to an employer plan.

Rollovers Into an Employer Plan. You can roll over after-tax contributions to an eligible 401(a), 403(a) or 403(b) employer plan using a direct rollover if the plan provides separate accounting for amounts rolled over, including separate accounting for the after-tax contributions and earnings on those contributions.

You cannot roll over after-tax contributions to a 457 plan.

If you want to roll over your after-tax contributions to an employer plan that accepts rollovers of after-tax contributions, you cannot have the after-tax contributions paid to you first. You must request CalSTRS to make a direct rollover on your behalf.

Rollover Into a Roth IRA. You can roll over after-tax contributions to a Roth IRA. The after-tax contributions will not be included in your taxable income (see page 10).

What Payments Cannot Be Rolled Over?

The following payments cannot be rolled over:

- **Payments spread over long periods.** You cannot roll over a payment if it is part of a series of equal (or almost equal) payments (“periodic payments”) that are made at least once a year and that will last for:
 - » Your lifetime (or a period measured by your life expectancy), or
 - » Your lifetime and your beneficiary’s lifetime (or a period measured by your joint life expectancies), or
 - » A period of 10 years or more.

- **Required minimum distributions.** When you reach age 70½ or retire, whichever is later, a certain portion of your CalSTRS payment cannot be rolled over because it is a “required minimum distribution” that must be paid to you under federal law. CalSTRS will tell you if your payment includes amounts that cannot be rolled over.
- **Corrective distributions of contributions that exceed tax law limitations.**
- **Distributions less than \$200.**

How Do I Do a Rollover?

There are two ways to do a rollover. You can do either a direct trustee-to-trustee rollover or a 60-day rollover.

Direct Rollover

A direct rollover is a direct payment of your CalSTRS benefit payment to an IRA or an eligible employer plan. If you do a direct rollover, CalSTRS will make the payment directly to your IRA or employer plan. You can choose a direct rollover of all or any portion of your payment that is an eligible rollover distribution.

Except when making a direct rollover to a Roth IRA, you are not taxed on any taxable portion of your payment for which you choose a direct rollover until you later take it out of a Traditional IRA or employer plan. In addition, no income tax withholding is required for any taxable portion of your CalSTRS payment for which you choose a direct rollover.



You may roll over your payment to a qualified IRA or an eligible employer plan that will accept the rollover.

Direct Rollover to a Qualified IRA. You can open a qualified IRA, including a Roth IRA, to receive the direct rollover. If you choose to have your payment made directly to a qualified IRA, contact the IRA sponsor (usually a financial institution) to find out how to have your payment made in a direct rollover to a qualified IRA at that institution.

If you are unsure of how to invest your money, you can temporarily establish an IRA to receive the payment. If you do this, make sure you can move all or a part of your payment to another qualified IRA at a later date without penalties or other limitations.

Contact the IRA sponsor to learn more. Also see IRS Publication 590, *Individual Retirement Arrangements*, for more information, 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 employer plan and you want to make a direct rollover to that plan, ask the plan's administrator if it will accept your rollover. An eligible employer plan is not legally required to accept a rollover.

If the employer plan accepts your rollover, the plan may restrict the circumstances under which you may later receive a distribution of the rollover amount or may require spousal

consent before any subsequent distribution. Subsequent distributions of your rollover from the plan also may be subject to different tax rules than CalSTRS payments. Contact the plan's administrator to learn more before making a decision.

If your new employer's plan does not accept a rollover, you can choose a direct rollover to a qualified IRA.

Direct Rollover of a Series of Payments.

If you receive a payment that can be rolled over to a qualified IRA or an eligible employer plan that will accept it, and it is paid in a series of payments for less than 10 years, your choice to make or not make a direct rollover for the payment will apply to all later payments in the series until you change your election. You may change your election for any later payment in the series at any time.

If you do a direct rollover, your eligible rollover distributions are not taxed at the time of distribution. You will pay income taxes on the taxable portion you directly roll over when you withdraw your funds.

60-day Rollover

If you receive a CalSTRS payment that is rollover eligible, you can still decide to roll over all or part of it by depositing it into an IRA or employer plan that accepts rollovers. You will



The rules of the IRA or employer plan that holds your rollover determine your investment options, fees and rights to payments from the IRA or plan. For example, no spousal consent rules apply to IRAs, and IRAs cannot provide loans. Also, your rollover is subject to the tax rules that apply to the IRA or plan.

have 60 days after you receive your CalSTRS payment to deposit the amount you received in an IRA or employer plan.

CalSTRS payments made to you are subject to a 20 percent federal income tax and a state income tax withholding at 10 percent of your federal tax withholding unless you request no state income tax withholding. If you do a 60-day rollover and do not make up the taxed portion from other sources (for example, your savings), you may have to pay additional penalties for an early distribution.

A rollover into a Roth IRA is not tax free except to the extent the funds represent after-tax contributions (also see page 9). For CalSTRS payments rolled over to a Roth IRA in 2010, you can spread the taxable amount over a two-year period starting in 2011.

How Can a Rollover Affect My Taxes?

Your taxes will depend on whether you decide to roll over an eligible payment and on whether you decide to do a direct rollover or a 60-day rollover.

What Are the Tax Consequences If I Do Not Do a Direct Rollover?

If you do not do a direct rollover, CalSTRS is required to withhold 20 percent of the payment for federal income tax and, if you

choose, will withhold 10 percent of your federal income tax withholding for state income tax. (For example, if you have 20 percent federal tax withholding, your state withholding will be 2 percent.)

In order to roll over the entire payment in a 60-day rollover, you must use other funds to make up for the 20 percent withheld for federal tax and any state tax withheld. If you do not roll over the entire amount of the payment, the portion not rolled over will be taxed—and also subject to the 10 percent additional federal income tax (and the 2.5 percent additional state income tax) on early distributions if you are under age 59½, unless an exception applies.

When you prepare your income tax returns for the year, unless you made a rollover within 60 days (see page 6), you must report the full amount of your CalSTRS payment as a taxable payment.

No income tax will be withheld if your CalSTRS payments for the year are less than \$200.

If I Do Not Do a Rollover, Will I Have to Pay the Additional Income Taxes on Early Distributions?

If you are under age 59½, you will have to pay the 10 percent additional federal income tax and 2.5 percent additional state income tax on early distributions of any CalSTRS payment,

How a Rollover Can Affect Your Taxes

Assume the taxable portion of your payment that can be rolled over is \$10,000, and you choose to have it paid to you. CalSTRS will withhold 20 percent for federal tax and, if you choose, will withhold 10 percent of your federal income tax withholding (2 percent if your federal tax withholding is at 20 percent) for California tax, leaving you with \$7,800. The \$2,200 withheld will be sent to the IRS and the California Franchise Tax Board as income tax withholding.

Within 60 days after receiving the \$7,800, you may roll over the entire \$10,000 to a Traditional IRA or an eligible employer plan. To do this, you would roll over the \$7,800 you received from CalSTRS and add \$2,200 from your out-of-pocket sources (for example, your savings or a loan). In this case, the entire \$10,000 will not be taxed until you withdraw it from the Traditional IRA or employer plan. In addition, if you roll over the entire \$10,000, you may get a refund from the IRS and FTB of part or all of the \$2,200 withheld when you file your income tax return.

Be aware that if you roll over only \$7,800, the \$2,200 you did not roll over will be taxed in the year it was withheld. It also may be subject to a penalty for early distribution. When you file your income tax return, you may still get a refund of part of the \$2,200 withheld. However, any refund may be larger if you roll over the entire \$10,000.

including amounts withheld for income tax, that you do not roll over unless one of the exceptions applies. These taxes are in addition to the regular federal and state income taxes on the payment not rolled over.

The 10 percent additional federal income tax and the 2.5 percent additional state income tax do not apply to the following CalSTRS payments:

- Payments made after you separate from service if you will be at least age 55 in the year of the separation.
 - Payments that start after you separate from service if paid at least annually in equal or close to equal amounts over your life or life expectancy (or the lives or joint life expectancies of you and your beneficiary).
 - Payments made due to disability.
 - Payments after your death.
 - Corrective distributions of contributions that exceed tax law limitations.
 - Payments made directly to the government to satisfy a federal tax levy.
 - Payments made under a qualified domestic relations order (QDRO).
 - Payments up to the amount of your deductible medical expenses.
- There is no exception for payments after separation from service that are made after age 55.
 - The exception for qualified domestic relations orders does not apply. However, a special rule applies under which, as part of a divorce or separation agreement, a tax-free transfer may be made directly to an IRA of a spouse or former spouse.
 - The exception for payments made at least annually in equal or close to equal amounts over a specified period applies without regard to whether you have had a separation from service.
 - There may be additional exceptions for (1) payments for qualified higher education expenses, (2) payments up to \$10,000 used in a qualified first-time home purchase, and (3) payments after you have received unemployment compensation for 12 consecutive weeks, or would have been eligible to receive unemployment compensation but for self-employed status.

If I Do a Rollover to an IRA, Will the Additional Income Taxes Apply to Early Distributions From the IRA?

If you receive a payment from an IRA when you are under age 59½, you will have to pay the 10 percent additional federal income tax and 2.5 percent additional state income tax on early distributions from the IRA, unless an exception applies. In general, the exceptions to the additional federal and state income taxes for early distributions from an IRA are the same as the exceptions listed for early distributions from a plan. However, there are a few differences for payments from an IRA, including:

Voluntary Withholding

If any portion of your payment is taxable but is not rollover eligible (see page 5), the mandatory withholding rules do not apply. In this case, you may elect not to have withholding apply to that portion. If you do nothing, both federal and state income tax withholding will be taken out of this portion of your payment.

If You Want to Elect Out-of-State Withholding

To elect out-of-state California tax withholding if your payment is from the Defined Benefit Program, complete the *Income Tax Withholding Preference Certificate* (form AD 908), available at CalSTRS.com. To elect out-of-state withholding if your payment is from the Cash Balance Benefit Program, complete the *Cash Balance Benefit Program Income Tax Withholding Preference* (form CB 584) which is part of the Retirement Benefit Application and the Termination Benefit Application packages at CalSTRS.com.

Special Rules and Options

If Your Payment Includes After-Tax Contributions

After-tax contributions included in a CalSTRS payment are not taxed. If you have pre-1987 after-tax contributions maintained in a separate account, a special rule may apply to determine whether the after-tax contributions are included in a payment.

You may roll over a CalSTRS payment that includes after-tax contributions to an IRA through either a direct rollover or a 60-day rollover (see page 4). You must keep track of the aggregate amount of the after-tax contributions in all of your IRAs (in order to determine your taxable income for later payments from the IRAs). If you do a direct rollover of only a portion of the amount paid from CalSTRS and a portion is paid to you, each of the payments will include an allocable portion of the after-tax contributions.

If you do a 60-day rollover to an IRA of only a portion of your CalSTRS payment made to you, the after-tax contributions are treated as rolled over last. For example, assume you are receiving a complete distribution of your benefit that totals \$12,000, of which \$2,000 is after-tax contributions. In this case, if you roll over \$10,000 to an IRA in a 60-day rollover, no amount is taxable because the \$2,000 amount not rolled over is treated as being after-tax contributions. However, CalSTRS will still withhold 20 percent for federal tax and 10 percent of your federal tax withholding for state tax, if you choose to have state tax withheld on the taxable amount.

You may roll over all of a payment that includes after-tax contributions to an employer plan but only through a direct rollover—and only if the receiving plan separately accounts for after-tax contributions and is not a governmental section 457(b) plan. You can do a 60-day rollover for the part of your CalSTRS payment that includes after-tax contributions to an employer plan but only up to the amount of the payment that would be taxable if not rolled over.

If You Miss the 60-Day Rollover Deadline

Generally, the 60-day rollover deadline cannot be extended. However, the IRS has limited authority to waive the deadline under certain extraordinary circumstances, such as when external events prevent you from completing the rollover by the 60-day rollover deadline.

To apply for a waiver, you must file a private letter ruling request with the IRS. Private letter ruling requests require the payment of a nonrefundable user fee. For more information, see IRS Publication 590, *Individual Retirement Arrangements*.

If You Were Born On or Before January 1, 1936

If you were born on or before January 1, 1936, and receive a lump-sum distribution that you do not roll over, special rules for calculating the tax on the payment may apply.

You may elect to have your lump-sum distributions taxed under favorable rates. The election is also available to your beneficiaries, including your current or former spouse who was named as an alternate payee under a qualified domestic relations order. The special tax treatment is not available for any portion of the lump-sum distributions rolled over to another plan. You may choose among the options listed below for computing the tax on your lump-sum distribution:

- 10-year averaging of the entire distribution.
- 10-year averaging of the post-1973 portion of the distribution.
- Having the portion of the distribution attributable to your pre-1974 participation in CalSTRS taxed at a flat 20 percent capital gains rate.

The rules on special tax treatments are complex. For more information, see IRS Publication 575, *Pension and Annuity Income*, and IRS form 4972.

If You Roll Over Your Payment to a Roth IRA

You can roll over a payment from CalSTRS made before January 1, 2010, to a Roth IRA only if your modified adjusted gross income is not more than \$100,000 for the year the payment is made to you and, if married, you file a joint return. These limitations do not apply to CalSTRS payments made to you after 2009. If you did a rollover to a Traditional IRA because you were not eligible to do a rollover to a Roth IRA until after 2009, you can now elect to convert the Traditional IRA into a Roth IRA.

If you roll over your CalSTRS payment to a Roth IRA, a special rule applies under which the amount of the payment rolled over (reduced by any after-tax amounts) will be taxed. However, the 10 percent additional federal income tax and 2.5 percent additional state income tax on early distributions will not apply (unless you take the amount rolled over out of the Roth IRA within five years, counting from January 1 of the year of the rollover). For CalSTRS payments during 2010 that are rolled over to a Roth IRA, the taxable amount can be spread over a two-year period starting in 2011.

If you roll over your payment to a Roth IRA, later payments from the Roth IRA that are qualified distributions will not be taxed, including earnings after the rollover. A qualified distribution from a Roth IRA is a payment made after you are age 59½—or after your death or disability, or as a qualified first-time homebuyer distribution of up to \$10,000—and after you have had your Roth IRA for at least five years. In applying this five-year rule, you count from January 1 of the year for which your first contribution was made to the Roth IRA. Payments from the Roth IRA that are not qualified distributions will be taxed to the extent of earnings after the rollover, including the 10 percent additional federal income tax and 2.5 percent additional state income tax on early distributions, unless an exception applies. You do not have to take required minimum distributions from a Roth IRA during your lifetime. For more information, see IRS Publication 590, *Individual Retirement Arrangements*.

You cannot roll over a payment from CalSTRS to a designated Roth IRA account in an employer plan.

CalSTRS is not responsible for assuring your eligibility to make a rollover to a Roth IRA. Consult your tax adviser if you are interested in rolling over your payment to a Roth IRA.

If You Are Not a CalSTRS Member

Payments After a Member's Death

If you receive a distribution after a CalSTRS member's death that you do not roll over, the distribution generally will be taxed in the same manner described elsewhere in this notice. However, the 10 percent additional federal income tax and 2.5 percent additional state income tax on early distributions do not apply. The special rules described under the section "If you were born on or before January 1, 1936" applies only if the CalSTRS member was born on or before January 1, 1936.

Surviving Spouses

If you receive a CalSTRS payment as the surviving spouse of a deceased member, you have the same rollover options that the member would have had. In addition, if you choose to do a rollover to an IRA, you may treat the IRA as your own or as an inherited IRA.

An IRA you treat as your own is treated like any other IRA of yours, so payments made to you before you are age 59½ will be subject to the 10 percent additional federal income tax and 2.5 percent additional state income tax on early distributions, unless an exception applies. In addition, required minimum distributions from your Traditional IRA do not have to start until after you are age 70½.

If you treat the IRA as an inherited IRA, payments from the IRA will not be subject to the 10 percent additional federal income tax and 2.5 percent additional state income tax on early distributions. However, if the member had started taking required minimum distributions, you will have to receive required minimum distributions from the inherited IRA. If the member had not started taking required minimum distributions, you will not have to start receiving required minimum distributions from the inherited IRA until the year the member would have been age 70½.

Surviving Beneficiaries Other Than Spouses

If you receive a CalSTRS payment because of the member's death and you are a designated beneficiary other than a surviving spouse, the only rollover option you have is to do a direct rollover into an inherited IRA.

Payments from the inherited IRA will not be subject to the 10 percent additional federal income tax and 2.5 percent additional state income tax on early distributions. You will have to receive required minimum distributions from the inherited IRA.

Payments Under a Qualified Domestic Relations Order

If you are the spouse or former spouse of a CalSTRS member who receives a payment from CalSTRS under a qualified domestic relations order, you generally have the same options the member would have (for example, you may roll over the payment to your own IRA or an eligible employer plan that will accept it). Payments under the QDRO will not be subject to the 10 percent additional federal income tax or 2.5 percent additional state income tax on early distributions.

If You Are a Nonresident Alien

If you are a nonresident alien and you do not do a direct rollover to a U.S. IRA or a U.S. employer plan, CalSTRS is generally required to withhold 30 percent of the

payment for federal income tax. If the amount withheld exceeds the amount of tax you owe (as may happen if you do a 60-day rollover), you may request an income tax refund by filing IRS Form 1040-NR and attaching your IRS Form 1042-S. See Form W-8BEN to claim that you are entitled to a reduced rate of withholding under an income tax treaty. For more information, see also IRS Publication 519, *U.S. Tax Guide for Aliens*, and IRS Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities*.

Other Special Rules

If a payment is one in a series of payments for less than 10 years, your choice whether to make a direct rollover will apply to all later payments in the series, unless you make a different choice for later payments.

If your payments for the year are less than \$200, CalSTRS will not do a direct rollover and is not required to withhold federal or state income tax. However, you may do a 60-day rollover.

When electing how to receive a CalSTRS payment that is rollover eligible, any amount you do not designate for a rollover will be mailed directly to you. Any payment made to you is subject to the tax consequences in this notice.

You may have special rollover rights if you recently served in the U.S. Armed Forces. For more information, see IRS Publication 3, *Armed Forces' Tax Guide*.

For More Information

Find more information on the federal tax treatment of payments from employer plans in IRS Publication 575, *Pension and Annuity Income*, IRS Publication 590, *Individual Retirement Arrangements*, and IRS Publication 571, *Tax-Sheltered Annuity Plans (403(b) Plans)*. These publications are available from a local IRS office, at irs.gov or by calling 800-829-3676.

For information on state income tax, contact the California Franchise Tax Board at ftb.ca.gov or call 800-852-5711 (or 916-845-6500 if calling from outside the U.S.).

We recommend contacting the IRS or a professional tax adviser before taking a payment from CalSTRS.

CalSTRS Resources



WEB

CalSTRS.com

Click *Contact Us* to e-mail

403bCompare.com

www.Pension2.com

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California State Teachers' Retirement System

COM 1357 (rev 6/11)

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