

Special Tax Notice: Your Rollover Options

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 an IRA or an employer plan. This notice is intended to help you decide whether to do such a rollover.

Rules that apply to most CalSTRS 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 provided. In general, California law conforms to the Internal Revenue Code. However, there are continuing differences between California and federal law. For additional information, visit ftb.ca.gov.

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 this notice. 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.

GENERAL INFORMATION ABOUT ROLLOVERS

How can a rollover affect my taxes?

You will be taxed on your CalSTRS payment if you do not roll it over. If you are under age 59½ and do not do a rollover, you also will have to pay a 10 percent additional federal income tax and a 2.5 percent additional California state tax on early distributions, unless an exception applies).

If you do a rollover, however, you will not have to pay tax until you receive payments later and the 10 percent additional federal income tax and 2.5 percent additional state income tax will not apply if those payments are made after you are age 59½, or if an exception applies.

Where may I roll over my CalSTRS payment?

You may roll over the payment to either an IRA (an individual retirement account or individual retirement annuity) or an employer plan (a tax-qualified plan, section 403(b) plan, or governmental section 457(b) plan) that will accept the rollover. The rules of the IRA or employer plan that holds the rollover will determine your investment options, fees and rights to payment from the IRA or employer plan. For example, no spousal consent rules apply to IRAs and IRAs may not provide loans. Further, the amount rolled over will become subject to the tax rules that apply to the IRA or employer plan.

How do I do a rollover?

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

Direct rollover: If you do a direct rollover, CalSTRS will make the payment directly to your IRA or an employer plan. You should contact the IRA sponsor or the administrator of the employer plan for information on how to do a direct rollover.

60-day rollover: If you do not do a direct rollover, you still may do a rollover by making a deposit into an IRA or eligible employer plan that will accept it. You will have 60 days after you receive your CalSTRS payment to make the deposit.

If you do not do a direct rollover, CalSTRS is required to withhold 20 percent of the payment for federal income taxes. If you choose to have state tax withheld, CalSTRS will withhold at 10 percent of your federal income tax withholding. This means that, 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 taxes and the 10 percent of your federal income tax withholding withheld for state taxes. If you do not roll over the entire amount of the payment, the portion not rolled over will be taxed and will be 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.

How much may I roll over?

If you wish to do a rollover, you may roll over all or part of the amount eligible for rollover. Any CalSTRS payment is eligible for rollover, except:

- Benefit payments spread over a period of at least 10 years or over your life or life expectancy (or the lives or joint life expectancy of you and your beneficiary).
- Required minimum distributions after age 70½ (or after death).
- Corrective distributions of contributions that exceed tax law limitations.

CalSTRS can tell you what portion of a payment is eligible for rollover.

If I don't do a rollover, will I have to pay 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, you will have to pay the 10 percent additional federal income tax and 2.5 percent additional state income tax on early distributions for any CalSTRS payment, including amounts withheld for income tax, that you do not roll over, unless one of the exceptions listed below applies. This tax is 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 expectancy 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.

If I do a rollover to an IRA, will the 10 percent additional federal income tax and the 2.5 percent additional state income tax 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 above for early distributions from a plan. However, there are a few differences for payments from an IRA, including:

- 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 are 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.

SPECIAL RULES AND OPTIONS

If Your Payment Includes After-Tax Contributions

After-tax contributions included in a CalSTRS payment are not taxed. If a payment is only part of your benefit, an allocable portion of your after-tax contributions is generally included in the payment. 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 to an IRA a CalSTRS payment that includes after-tax contributions through either a direct rollover or a 60-day rollover. 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.

You may roll over to an employer plan all of a payment that includes after-tax contributions, 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 to an employer plan of part of a CalSTRS payment that includes after-tax contributions, 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 the limited authority to waive the deadline under certain extraordinary circumstances, such as when external events prevented 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 amount of the tax on the payment might apply to you. For more information, see IRS Publication 575, *Pension and Annuity Income*.

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 to 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 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 payments from CalSTRS 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 the 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 a 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 a 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 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 will generally 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 rule 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.

If you are a surviving spouse. 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, as described elsewhere in this notice. 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 that 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 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.

If you are a surviving beneficiary other than a spouse.

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 to 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 (QDRO), 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 taxes. 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 1040NR and attaching your IRS Form 1042-S. See Form W-8BEN for claiming 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 is not required to allow you to do a direct rollover and is not required to withhold for federal income taxes. However, you may do a 60-day rollover.

When electing how to receive a CalSTRS payment that is rollover eligible, any amount not designated for rollover will be mailed directly to you.

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

See the *Tax Considerations for Rollovers* booklet at CalSTRS.com. You may wish to consult a professional tax adviser before taking a payment from CalSTRS.

In addition, you will 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 (403(b) Plans)*, 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-TAX-FORM (800-829-3676).

For information on state 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.).