Special Tax Notice
(Lump Sum Distributions)

A general guide regarding the tax consequences of lump sum distributions, such as the BackDROP or refund of employee contributions (2011 Tier).

MPERS

Serving those who keep us safe.

MoDOT & Patrol Employees' Retirement System

MoDOT & Patrol Employees' Retirement System

Mailing Address
PO Box 1930
Jefferson City, MO 65102-1930

Building Address
1913 William Street
Jefferson City, MO 65109

Business Hours
Monday - Friday
7:30 a.m. - 4:30 p.m.

Phone Number
(573) 298-6080

Toll Free
(800) 270-1271

Fax
(573) 522-6111

Email Address
mpers@mpers.org

Website
www.mpers.org

MPERS is a tax qualified 401(a) governmental defined benefit plan.
The information contained in this brochure only applies to
lump sum distributions before the funds leave MPERS.

Table of Contents

- The information contained in this brochure is excerpted from information published by the IRS (Safe Harbor Explanations - Eligible Rollover Distributions Notice 2018-74 dated October 1, 2018) and is being provided for informational purposes only. MPERS is **NOT** responsible for the accuracy of the information contained herein and members should consult their tax advisor regarding any planned distributions.

- The contents of this brochure do not amend or overrule any applicable statute, IRS Code or administrative rule. In the event of conflict, the applicable statute, IRS Code or administrative rule will prevail.

INTRODUCTION

You are receiving this notice because all or a portion of a payment you are receiving from the MoDOT and Patrol Employees' Retirement System (MPERS) is eligible to be rolled over to an eligible individual retirement account (IRA) or another eligible employer retirement plan or account. This notice is intended to help you decide whether or not to do such a rollover.

MPERS operates as a tax qualified plan under section 401(a) of the Internal Revenue Code.

Rules that apply to most payments from a plan 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.

Simplified Summary of Payment Options

A lump-sum distribution from MPERS that is eligible for rollover, may be taken in one of the three ways listed below. The choice you make will affect the taxes and/or penalties you owe. This *Special Tax Notice* brochure is provided for your convenience only; it is not intended as tax advice. MPERS recommends that you consult a tax professional before making your payment election.

1. Rollover Option
   - The payment is made directly to an IRA or employer plan.
   - No income tax is withheld from your transfer amount.

2. Cash Option
   - BackDROP distribution is deposited electronically into the same account authorized for your monthly retirement benefit payment. If the distribution is a refund of your employee contributions, it is paid to you by check.
   - When electing the cash option, MPERS is required by law to withhold 20% of the taxable portion of the payment and send it to the IRS as federal income tax.
   - The payment is subject to an additional 10% tax penalty for early distributions (unless an exception applies). Applicable state taxes may apply, but will not be withheld from the payment.

3. Combination Cash and Rollover Option
   - This option allows you to specify how much of the payment you wish to receive under the cash option and how much gets rolled over.
   - The combination option has the same tax implications as shown in items 1 and 2 above.

How can a rollover affect my taxes?

You will be taxed on a payment from MPERS if you do not roll it over. If you are under age 59½ and do not do a rollover, you will also have to pay a 10% additional income tax on early distributions (generally, distributions made before age 59½), unless an exception applies.

However, if you do a rollover, you will not have to pay tax until you receive payments later and the 10% additional income tax will not apply if those payments are made after you are age 59½ (or if an exception applies).

What types of retirement accounts and plans may accept my rollover?

You may roll over the payment to either an eligible individual retirement account or individual retirement annuity or an eligible 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 elect a direct rollover, MPERS 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 may still do a rollover by making a deposit into an IRA or eligible employer plan that will accept it. Generally, you will have 60 days after you receive the payment to make the deposit. If you do

State of Missouri Deferred Compensation Plan

You have the option of rolling the lump-sum distribution into the State of Missouri Deferred Compensation Plan. Since it is an eligible plan, your distributions from the 457 plan are generally not subject to the 10% penalty regardless of your age at the time of the distribution. You can defer taxation on the balance until you start withdrawing money from the plan (must begin at age 72), at which time you will be taxed only on the amount withdrawn. If you retire after age 55, but prior to age 59½, you have access to your BackDROP funds from the State of Missouri Deferred Compensation Plan without an early withdrawal penalty.

Phone: (800) 392-0925
www.modeferredcomp.org

not do a direct rollover, MPERS is required to withhold 20% of the payment for federal income taxes. 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% withheld. 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% additional 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 all or part of the amount eligible for rollover. Any payment from MPERS is eligible for rollover, **except**:

- Certain 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 72 (or after death); and
- Corrective distributions of contributions that exceed tax law limitations.

Individuals Over Age 72 and Required Minimum Distributions

Required minimum distributions must begin by April 1 of the year following the year you turn age 72 or retire, whichever is later. You may roll over that portion of your eligible rollover distribution that is **not** a required distribution (under Section 401(a)(9) of the Internal Revenue Code) into a traditional IRA or eligible employer plan. Required minimum distributions may not be rolled over and must be paid to you.

If I don't do a rollover, will I have to pay the 10% additional income tax on early distributions?

The IRS generally defines an early distribution or early withdrawal as the taking of funds out of a retirement plan before a person reaches age 59½.

If you are under age 59½, you will have to pay the 10% additional income tax on early distributions for any payment from MPERS (including amounts withheld for income tax) that you do not roll over, unless one of the exceptions listed below applies. This tax applies to the part of the distribution that you must include in income and is in addition to the regular income tax on the payment not rolled over.

The 10% additional income tax does **not** apply to the following payments from MPERS:

- 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 from a governmental plan made after you separate from service if you are a **public safety employee** and you will be at least age 50 in the year of the separation;
- 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 to an alternate payee under a Division of Benefits Order (DBO);
- Payments up to the amount of your deductible medical expenses; and
- Certain payments made while you are on active duty if you were a member of a reserve component called to duty after September 11, 2001 for more than 179 days.

If I do a rollover to an IRA, will the 10% additional 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% additional income tax on early distributions on the part of the distribution that you must include in income, unless an exception applies. In general, the exceptions to the 10% additional income tax 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:

- The exception for payments made after you separate from service if you will be at least age 55 in the year of the separation (or age 50 for qualified public safety employees) does not apply.
- The exception for qualified domestic relations orders (QDROs) does not apply (although 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 or not 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 for health insurance premiums after you have received unemployment compensation for 12 consecutive weeks (or would have been eligible to receive unemployment compensation but for self-employed status).

Will I owe state income taxes?

This notice does not describe any state or local income tax rules including withholding rules. You may wish to consult a professional tax advisor and your state and/or local taxing authority about your state and local tax liability before taking a lump-sum distribution.

If your payment includes after-tax contributions

After-tax contributions included in a payment are not taxed. If a payment is only part of your benefit, an allocable portion of your after-tax contributions is 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. In addition, special rules apply when you do a rollover, as described below.

You may roll over to an IRA a 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 MPERS and at the same time the rest is paid to you, the portion directly rolled over consists first of the amount that would be taxable if not rolled over. For example, assume you are receiving a distribution of $12,000, of which $2,000 is after-tax contributions. In this case, if you directly roll over $10,000 to an IRA (that is not a Roth IRA), no amount is taxable because the $2,000 amount not directly rolled over is treated as being after-tax contributions.

If you do a 60-day rollover to an IRA of only a portion of a payment made to you, the after-tax contributions are treated as rolled over last. For example, assume you are receiving a distribution of $12,000, of which $2,000 is after-tax contributions, and no part of the distribution is directly rolled over. In this case, if you roll over $10,000 to an IRA (that is not a Roth 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 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. Under certain circumstances, you may claim eligibility for a waiver of the 60-day rollover deadline by making a written self-certification. Otherwise, to apply for a waiver from the IRS, 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–A, *Contributions to Individual Retirement Arrangements (IRAs)*.

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 are an eligible retired public safety officer and your payment is used to pay for health coverage or qualified long-term care insurance

If you retired as a **public safety officer** from MPERS, and your retirement was by reason of disability or was after normal retirement age, you can exclude from your taxable income plan payments paid directly as premiums to an accident or health plan (or a qualified long-term care insurance contract) that your employer maintains for you, your spouse, or your dependents, up to a maximum of $3,000 annually. For this purpose, a public safety officer is a law enforcement officer, firefighter, chaplain, or member of a rescue squad or ambulance crew.

If you roll over your payment to a Roth IRA

If you roll over a payment from MPERS 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% additional 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).

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% additional 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–A, *Contributions to Individual Retirement Arrangements (IRAs)*, and IRS Publication 590–B, *Distributions from Individual Retirement Arrangements (IRAs)*.

You cannot roll over a distribution from MPERS to a designated Roth account in another employer plan.

If you are not a participant of MPERS

Payments after death of the participant. If you receive a distribution after the participant'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% additional income tax on early distributions and the special rules for public safety officers do not apply, and the special rule described under the section "If you were born on or before January 1, 1936" applies only if the participant was born on or before January 1, 1936.

If you are a surviving spouse. If you receive a payment from MPERS as the surviving spouse of a deceased participant, you have the same rollover options that the participant 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% additional income tax on early distributions (unless an exception applies) and required minimum distributions from your IRA do not have to start until after you are age 72.

If you treat the IRA as an inherited IRA, payments from the IRA will not be subject to the 10% additional income tax on early distributions. However, if the participant had started taking required minimum distributions, you will have to receive required minimum distributions from the inherited IRA. If the participant had not started taking required minimum distributions from MPERS, you will not have to start receiving required minimum distributions from the inherited IRA until the year the participant would have been age 72.

If you are a surviving beneficiary other than a spouse. If you receive a payment from the Plan because of the participant'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% additional income tax on early distributions. You will have to receive required minimum distributions from the inherited IRA.

Payments under a Division of Benefits Order (DBO). If you are the spouse or former spouse of the participant who receives a payment from MPERS under a DBO, you generally have the same options the participant 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 DBO will not be subject to the 10% additional 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 U.S. employer plan, instead of withholding 20%, MPERS is generally required to withhold 30% 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 Form 1040NR and attaching your 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, MPERS 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.

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

This *Special Tax Notice* summarizes only the federal (not state or local) tax rules that might apply to your lump sum distribution. The rules are complex and contain many conditions and exceptions that may not be included in this notice.

You may wish to consult with an MPERS benefit specialist or a professional tax advisor, before taking a lump-sum payment from MPERS. Also, you can find more detailed information on the federal tax treatment of payments from employer plans in:

- IRS Publication 575, *Pension and Annuity Income*
- IRS Publication 590–A, *Contributions to Individual Retirement Arrangements (IRAs)*
- IRS Publication 590–B, *Distributions from Individual Retirement Arrangements (IRAs)*
- IRS Publication 571, *Tax-Sheltered Annuity Plans (403(b) Plans)*

These publications are available from a local IRS office, on the web at **www.irs.gov**, or by calling **1-800-TAX-FORM**.

February 2020