

**CITY OF NEW ORLEANS
EMPLOYEES RETIREMENT SYSTEM
SPECIAL TAX NOTICE ABOUT CERTAIN
PLAN PAYMENTS**

This notice explains how you can continue to defer federal income tax on certain amounts that you receive from the plan. The notice contains important information about the taxation of your benefits. *Please review this information carefully; neither your employer nor the trustees can provide you advice about the taxation of your benefits.*

Three types of payments may be eligible for rollover:

- Distributions from a DROP account that are made in the form of a single sum;
- The refund of your contributions to the plan (including interest), whether contributions made on a before or after-tax basis; or
- Level installment payments over a designated period of less than ten years that are made from your DROP account.

Distributions that are made over your life expectancy or the joint life expectancy of you and your spouse or beneficiary are not eligible for rollover.

Rollovers can be made to an individual retirement account (called an IRA) or an eligible employer plan. There are two ways to make a rollover:

- You can direct the trustees to transfer all or a part of your eligible distribution from the plan directly to your IRA or to your new employer's plan (this is called a *direct rollover*).
- You can also make a rollover by receiving your distribution and depositing all or a portion of the distribution in an IRA or a new

employer's plan. *Your deposit to an IRA or plan must be completed not later than 60 days after your benefits are distributed from the plan* (this is called a *participant rollover*).

1. Eligible IRAs and Plans:

Only certain types of IRAs can accept rollovers; your distribution *cannot* be rolled over to a Roth IRA, a SIMPLE IRA, or a Coverdell Education Savings Account (formerly known as an education IRA).

The term "eligible employer plan" now includes a plan qualified under section 401(a) of the Internal Revenue Code, such as LASERS or a 401(k), profit-sharing, defined benefit, stock bonus, or money purchase plan maintained by a private employer; a section 403(a) annuity plan; a section 403(b) tax-sheltered annuity; and an eligible section 457(b) plan maintained by a governmental employer (a governmental 457 plan). An eligible employer plan is not legally required to accept a rollover.

You are responsible for designating an IRA or eligible employer plan to receive your rollover. Before you designate an IRA or plan, you should carefully review the available investment options, the fees and expenses related to the account (whether an IRA or maintained in a plan), and, most importantly, whether there are any penalties or other restrictions on the termination of your account and the transfer to another IRA or plan, and whether there are additional limits on distributions or access to your funds.

Even if a plan accepts rollovers, it might not accept rollovers of certain amounts, such as your after-tax contributions. You are responsible for determining these limitations before you establish your account. If limits apply, you can roll over only part of your distribution to an IRA or split your rollover between an employer's plan and an IRA.

2. Consequences of a Rollover:

If you elect to make a *direct rollover*:

- Your distribution will not be subject to tax in the current year and no income tax will be withheld.
- You choose whether your payment will be made directly to an IRA or to an eligible employer plan.
- The taxable portion of your distribution will be subject to tax later, when it is finally distributed. Depending upon the type of plan, the later distribution may be subject to different tax treatment than it would have been if you received a taxable distribution from this plan.

If you make a *participant rollover*:

- You will receive only 80% of the taxable amount of your distribution; 20% of the taxable amount is automatically withheld and sent to the IRS as income tax withholding to be credited against your taxes.
- The taxable amount will be subject to taxation in the current year unless you roll it over or you are able to use special tax rules to reduce the tax you owe (see below).
- If you receive the payment before age 59 1/2, you may also have to pay an additional 10% penalty tax.
- You can roll over all or part of your distribution to an IRA or to your new employer's plan. Your rollover must be completed within 60 days after your distribution. The amount you roll over will not be taxed until you take it out of the IRA or plan.

3. *Time of Distribution:*

The trustees are generally required to provide you with this notice at least 30 days before the date of your distribution. This period

is intended to provide you with sufficient time to designate the method of distribution, establish an IRA or designate an employer's plan, and seek tax advice (if you believe it is necessary). You can waive all or a part of the 30-day period by completing and returning your distribution form to the trustees before the end of the 30-day period. Your distribution will be made as soon as possible after receipt of your completed forms.

4. *Payments and Distributions Eligible for Rollover:*

Types of Distributions Eligible for Rollover. The form of your distribution will determine whether it is eligible for rollover. Single sum distributions can generally be rolled over; these may be distributions of the balance of your DROP account or the refund of your contributions, whether made on a before-tax or after-tax basis. In addition, if you receive a series of payments from your DROP account over a period not in excess of ten years, all or any of the payments can be rolled over.

Distributions not Eligible for Rollover. Most distributions from the plan cannot be rolled over; these include:

- Distributions that are made over your life expectancy or over a scheduled period of ten years or more; and
- Any amounts you receive as required minimum distributions (either because you have attained age 70 1/2 or retired after age 70 1/2).

After-tax Contributions. If you made after-tax contributions, these contributions *can* now be rolled over. If the plan's records permit, the trustees will provide you with information about the amount of these contributions at the time that you receive a distribution. Several special considerations apply to the rollover of these amounts:

- If your roll over is to an IRA, you must track and report to the IRS (on the

applicable forms) the amount of your after-tax contributions. This permits the nontaxable amount of any future distribution from your IRA to be determined.

- If your roll over is to an IRA, remember that the after-tax contributions **cannot** later be rolled over to another employer plan.
- You can roll over your after-tax contributions to an employer's plan, if the plan accepts these types of contributions and provides separate accounting of these amounts.

5. More Information About Direct Rollovers:

A direct rollover is the direct payment of all or a portion of your distribution to the IRA or an eligible employer plan that you designate. You are not taxed on any taxable portion of your payment that is directly rolled over, until it is distributed from the IRA or plan. In addition, no income tax withholding is required for any taxable portion of your distribution that is directly rolled over. Direct rollovers are not permitted if your distribution is less than \$200.

Direct Rollover to an IRA. You must open an IRA to receive the direct rollover. Contact your IRA sponsor (usually a brokerage house, financial institution or an insurance company) to obtain more information about direct rollovers to that institution. When you designate an IRA, make sure that the IRA will accept your distribution. Also determine if the terms of your IRA allow you to move all or a part of your payment to another IRA or a plan at a later date, without penalties or other limitations. See IRS Publication 590, Individual Retirement Arrangements, for more information on 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 maintains an eligible employer plan (defined above), ask your new employer whether the plan will accept

your rollover. An eligible employer plan is not legally required to accept rollovers. If the employer plan accepts your rollover, the plan may impose restrictions on investments and distributions. Review these restrictions carefully before you direct the trustees to make your rollover.

Rollover of Installment Payments. If you elect to directly roll over an eligible series of installment payments made from your DROP account, you can change your rollover election during the payment period. If you change, any amount that you elect to receive may be subject to income and penalty taxes. Amounts that you receive remain eligible for participant rollover. You can make a change by completing new directions and delivering them to the plan.

Change in Tax Treatment After a Direct Rollover. When you later receive a distribution of the amount you rolled over, the tax treatment may differ from the taxation of your distribution directly from this plan. **For example**, if you were born before January 1, 1936, you might be entitled to ten-year averaging or capital gain treatment, as explained below. However, if you have your benefit rolled over, your benefit may no longer be eligible for that special treatment. These rules are explained below.

6. More Information About Participant Rollovers:

If your distribution is eligible for rollover and a part is paid directly to you, it is subject to income tax in the year you receive it, unless you roll it over to an IRA or employer plan **within 60 days of distribution from the plan or it is a return of your after-tax contributions**. If you do not make a timely rollover, in limited circumstances special tax rules may reduce the amount of tax that you owe.

Mandatory Withholding. If you elect to receive any portion of a distribution that can otherwise be rolled over, such as a single sum, the trustees are required to withhold 20% of the taxable amount. This amount is sent to the IRS as federal income tax withholding. **For**

example, if you receive an \$8,000 refund of your contributions and \$6,000 is taxable, only \$4,800 will be paid to you; the plan must withhold \$1,200 as income tax. When you prepare your income tax return for the year, you must report \$6,000 as a taxable distribution. The \$1,200 that was withheld will be credited against any income tax you owe for the year.

Amounts paid over your life expectancy or a joint life expectancy are not subject to automatic withholding, although you can instruct the trustees to withhold.

Sixty-Day Rollover Option. If you receive a distribution that can be rolled over, you can still decide to make a roll over. You must contribute the portion of the distribution you elect to rollover to an IRA or plan within 60 days after you receive the distribution. The portion that is rolled over will not be taxed until you take it out of the IRA or plan.

You can roll over all of your eligible distribution, including an amount equal to the withholding. To roll over the entire amount, you must replace the withheld funds from other money sources within the 60-day period. If you roll over only the 80% of the taxable portion that you actually received, you will be taxed on the 20% that was withheld.

For Example: Assume that the amount of your distribution that is eligible for rollover is \$10,000 and you elect to have it paid directly to you. If the entire \$10,000 is taxable, you will receive \$8,000 and \$2,000 will be withheld and sent to the IRS. Within 60 days after receiving the \$8,000, you can roll over the entire \$10,000; you roll over the \$8,000 you actually received, and you obtain \$2,000 from other money sources (such as your savings, a loan, etc.). The entire \$10,000 is not taxed until you take it out of the IRA or plan. When you file your income tax return, you may get a refund of part or all of the \$2,000 that was withheld.

Additional 10% Tax If You Are Under Age 59 1/2. If you receive a taxable distribution before you reach age 59 1/2 and you do not roll

it over, in addition to the regular income tax, you may have to pay an extra penalty tax equal to 10% of the taxable portion of the distribution. The additional 10% tax generally does not apply to (a) payments that are paid after you separate from service with your employer during or after the year you reach age 55, (b) payments that are made because you retire due to disability, (c) payments that are paid as equal (or almost equal) payments over your life or life expectancy (or your and your beneficiary's lives or life expectancies), (d) payments that are paid directly to the government to satisfy a federal tax levy, or (e) payments that do not exceed the amount of your deductible medical expenses. 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 distribution and you do not roll it over, the distribution will be taxed in the year you receive it. If the payment qualifies as a "lump sum distribution," it may be eligible for special tax treatment.

A lump sum distribution is a payment of your entire interest within one year (including certain other similar plans of the employer) that is made after you have reached age 59 1/2 or because you separated from service. For a payment to be treated as a lump sum distribution, you must have been a participant in the plan for at least five years before payment was made. The special tax rules available for lump sum distributions are summarized below:

- ***Ten-Year Averaging.*** If you were born before January 1, 1936, you can make a one-time election to figure the tax on the lump sum distribution by using "10-year averaging" (using 1986 tax rates). Ten-year averaging often reduces the tax you owe.
- ***Capital Gain Treatment.*** If you were born before January 1, 1936, and you were a participant in the plan before 1974, you may elect to have the part of your distribution that is attributable to

your pre-1974 participation taxed as long-term capital gain at a rate of 20%.

There are other limits on the special tax treatment for lump sum distributions. For example, you can generally elect the treatment only once in your lifetime, and the election applies to all lump sum distributions that you receive in the same year. You may not elect special tax treatment if you rolled amounts into this plan from a 403(b) tax-sheltered annuity contract, a governmental 457 plan or from an IRA not originally attributable to a qualified employer plan. If you have previously rolled over a distribution from this plan (or certain other similar plans of the employer), you cannot use the special averaging treatment for later payments. If you roll over your payment to an IRA, a governmental 457 plan, or a 403(b) tax-sheltered annuity, the special tax treatment does not apply to later payments from that IRA, plan, or annuity. Also, if you roll over only a portion of your payment to an IRA, governmental 457 plan, or 403(b) tax-sheltered annuity, you will not be able to use the special tax treatment for the rest of the lump sum distribution. See IRS Form 4972 for additional information on lump sum distributions and how you elect the special tax treatment.

7. Surviving Spouses, Alternate Payees, and Other Beneficiaries:

In general, the rules summarized above apply to payments to beneficiaries and surviving spouses of employees. If you are a surviving spouse or beneficiary, you may choose to have a payment that can be rolled over paid in the form of a direct rollover to an IRA or to an eligible

employer plan or distributed to you. If you have the distribution made directly to you, you can roll over all or a portion in the form of a participant rollover.

If you are a surviving spouse or another beneficiary, your payment is generally not subject to the additional 10% tax described above, even if you are younger than age 59 1/2. You may be able to use the special tax treatment for lump sum distributions and the special rule for payments that include employer securities. If you receive a payment because of an employee's death, you may be able to treat the payment as a lump sum distribution if the employee met the appropriate age requirements, whether or not the employee had five years of participation in the plan.

8. 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. You should consult with a professional tax advisor before you receive a distribution. You can find more specific information on the tax treatment of payments from qualified employer 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 www.irs.gov, or by calling 1-800-TAX-FORMS.

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