



Teachers' Retirement System

Deferred Retirement Option Plan



DROP Distributions



The Retirement
Systems of
Alabama

Contact TRS

Phone

877-517-0020
334-517-7000

Fax

877-517-0021 or 334-517-7001

E-mail

trsinfo@rsa-al.gov

When sending an e-mail, please include your full name, employer, home mailing address and daytime phone number.

Mail

The Teachers' Retirement System of Alabama
P.O. Box 302150
Montgomery, AL 36130-2150

Web site

www.rsa-al.gov

Building Location

201 South Union Street
Montgomery, Alabama

Business Hours

8:00 a.m. - 5:00 p.m.
Monday - Friday

Please provide your full name and Social Security number on all faxes and letters.

Cover photos (from left to right): The Beacon of Light at the Elevated Acre, 55 Water Street, New York City; Silver Lakes, Anniston / Gadsden; Renaissance Ross Bridge Golf Resort & Spa, Hoover

Introduction

The Deferred Retirement Option Plan (DROP) became effective June 1, 2002. This voluntary plan allows members of the Teachers' Retirement System (TRS) to contract with the TRS to defer receipt of their retirement allowance and continue employment for a specific period of time. At DROP termination, the member may withdraw from active service and receive a retirement benefit based on his or her years of service credit at the time of enrollment in DROP plus either a lump-sum payment of the amount in their DROP account or be able to make a direct rollover of all or a portion of their DROP account balance. Please read this brochure thoroughly and keep it with your other benefit materials. It is a very useful tool when you have questions about DROP termination.

The information in this brochure is based on the Code of Alabama 1975, Title 16, Chapter 25, Article 9. This brochure is not intended as a substitute for the laws of Alabama governing the TRS nor will its interpretation prevail should a conflict arise between its contents and Article 9. Furthermore, the laws summarized here are subject to change by the Alabama Legislature. Do not rely solely upon the information provided in this brochure to make any decision regarding termination of DROP, but contact the TRS directly with any questions you may have.

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This brochure is a summary and is not intended to provide complete information about withdrawing RSA accounts or the taxation of withdrawn RSA accounts. Information provided in this brochure does not create an entitlement. Actual benefit obligations are incurred only when monthly benefits are granted.

DROP Termination

Completion of Contractual Obligation

If you complete your contractual obligation in DROP, i.e., participate in DROP between three to five years, and terminate employment, you may elect to receive the following funds in either a lump-sum payment or make a direct rollover to an eligible plan:

1. The monthly retirement allowance contributions plus interest (currently four percent). These contributions are based on the retirement option elected upon entering the DROP participation period.
2. Member contributions made to the TRS during the DROP participation period plus applicable interest.

The monthly retirement allowance you will receive after withdrawal from service may be recalculated to include accrued sick leave. However, the number of sick days converted cannot exceed the number of sick days you had on the date you entered DROP. You are not allowed to change the option for the monthly retirement allowance chosen at the beginning of the DROP participation period.

Payments will not be made until you withdraw from service. If you continue employment with an agency participating in the RSA, you will not be able to receive a distribution until you terminate employment.

Involuntary Termination, Disability, or Involuntary Transfer of Spouse

If you did not fulfill your contractual obligation due to involuntary termination, disability, or involuntary transfer of your spouse in the first three years of the DROP participation period, you are entitled to receive the same benefits as a member who has completed the contractual obligation. However, you will have fewer funds accumulated because the DROP participation

period is shorter.

Voluntary Termination

If you withdraw from service voluntarily within the first three years of DROP, you will **forfeit** the DROP funds based on the monthly retirement benefits paid to your account. However, you may elect to receive the following in either a lump-sum payment or make a direct rollover to an eligible plan:

1. Member contributions made to the TRS during the DROP participation period plus applicable interest.
2. Interest attributable to the monthly retirement allowance contributions made to the DROP account during the DROP participation period.

If sick leave conversion was selected when the member elected DROP participation, the monthly retirement allowance you will receive after withdrawal from service may be recalculated to include accrued sick leave. However, the number of sick days converted cannot exceed the number of sick days you had on the date you entered DROP. You are not allowed to change the option for the monthly retirement allowance chosen at the beginning of the DROP participation period.

Payments will not be made until you withdraw from service.

Death During DROP Participation

If a member dies anytime during the DROP participation period and the beneficiary is the spouse, the **spouse** may elect to receive the following funds in either a lump-sum payment or make a direct rollover to an eligible plan. **Non-spouse** beneficiary(s) may receive the following funds in a lump-sum payment or make a direct rollover to an IRA created for that purpose:

1. The monthly retirement allowance contributions plus interest (currently four percent). These contributions are based on the retirement option elected upon entering the DROP participation period.
2. Member contributions made to the TRS during the DROP participation period plus applicable interest.

Any retirement benefit based on the retirement option selected by the member at the beginning of the DROP participation period will be paid to the beneficiary(s). The monthly retirement allowance may be recalculated to include accrued sick leave. However, the number of sick days converted cannot exceed the number of sick days the participant had on the date he or she entered DROP. The beneficiary is not allowed to change the option for the monthly retirement allowance chosen at the beginning of the DROP participation period.

A \$15,000 term life insurance benefit will be paid to the beneficiary(s) if the member was employed full-time. This benefit will be prorated if employment was not full-time.

No death before retirement benefit will be paid to the estate or beneficiary.

Continued Service after the DROP Participation Period

If you do not withdraw from service after completing your DROP participation, you will resume active contributing membership in the TRS for the purpose of earning creditable service. No time spent participating in DROP will be counted as creditable service. For example, if a member had 26 years of creditable service upon entering DROP and participated in DROP for five years; then worked two more years after completing his or her contractual obligation in DROP, the member would only have 28 years of

total creditable service. There would be two separate retirement allowance calculations; one based on 26 years of service and the other based on two years of service.

Upon withdrawal from service, you may elect to receive the following contributions in either a lump-sum distribution or make a direct rollover to an eligible plan:

1. The monthly retirement allowance contributions plus interest (currently four percent). These contributions are based on the retirement option elected upon entering the DROP participation period.
2. Member contributions made to the TRS during the DROP participation period plus applicable interest.

The monthly retirement allowance you will receive after withdrawal from service may be recalculated to include accrued sick leave. However, the number of sick days converted cannot exceed the number of sick days you had on the date you entered DROP. You are not allowed to change the option for the monthly retirement allowance chosen at the beginning of the DROP participation period.

An additional monthly retirement allowance based on your additional service since the end of the DROP participation period will be calculated using the retirement formula (Average Final Salary x Additional Years and Months of Service x 2.0125%). The Average Final Salary will be calculated only on the additional service since the end of DROP participation. This additional service can in no way be combined with service prior to participation in DROP. The retirement option will be the same option used in the original retirement allowance.

If the member dies or becomes disabled during the period of additional service, he or she will be considered as having retired on the date of death or commencement of disability. No death before retirement benefits will be made. However, the \$15,000 Group Term Life Insurance benefit would be payable to beneficiaries of full-time employees. The beneficiary will have any eligible benefits based on the option chosen by the member and the balance in the DROP account as previously described in **Death During DROP Participation** on page 4.

Distribution of DROP Account

No distribution from your DROP account will be made until you terminate employment with any RSA participating agency and the TRS receives the final contribution from your employer. Any recurring monthly benefit may be distributed electronically to your financial institution by completing the DIRECT DEPOSIT AUTHORIZATION form.

DROP participants have one of two ways to distribute the funds in their DROP account:

1. Receive a lump-sum payment of the total DROP account balance less the required 20% federal income tax withholding. No portion of the distribution is subject to state of Alabama income tax.
2. Rollover all or a portion of the account balance to a traditional IRA, another eligible employer retirement plan, a 403(b) Tax Sheltered Annuity, or a governmental 457(b) plan that accepts rollovers. **The RSA-1 Deferred Compensation Plan** (457 plan) accepts rollovers from your DROP account.

Read the **Special Tax Notice Regarding RSA Payments** in this brochure prior to making your selection. **All of the forms listed in this section are**

available from the TRS, your payroll officer or may be downloaded from our Web site.

Applying for DROP Distribution - Early Termination

1. Complete the REQUEST FOR DROP DISTRIBUTION AND ROLLOVER ELECTION form (RSA 10 D-D) required to authorize distribution of the DROP account balance. The election to receive either a lump-sum payment or to make a rollover will be made on this form. If you elect to have a lump-sum payment of your DROP account, the TRS will withhold 20% for federal income taxes. The form must be signed and notarized, but no employer certification is required. If you elect to rollover all or a portion of your DROP account, sign and have the form notarized before sending it to the Trustee of the eligible retirement plan you have elected to make your rollover to. The Trustee should mail the completed form to the TRS.
2. Complete the REQUEST FOR EARLY TERMINATION OF DROP form (TRS 10 D-E). Indicate the reason for the early termination and complete the federal income tax withholding certificate. Sign and have the form notarized before sending it to your employing agency for them to certify your employment. You and your employer need to complete the PEEHIP Insurance Authorization information on the reverse side of the form.
3. Send both the completed REQUEST FOR DROP DISTRIBUTION AND ROLLOVER ELECTION form and the REQUEST FOR EARLY TERMINATION OF DROP form to the TRS. If electing a rollover, the Trustee will send the REQUEST FOR DROP DISTRIBUTION AND ROLLOVER ELECTION form to the TRS. Both forms must be completed and returned to the TRS at least 30 days prior to termination of employment, if possible.

4. Supporting documentation must be included with the forms. If the termination is involuntary, submit a copy of the termination letter. If the termination is due to a disability, the DROP participant must complete and submit the REPORT OF DISABILITY PACKET. The STATEMENT OF EXAMINING PHYSICIAN form (also used to apply for a disability retirement) in the REPORT OF DISABILITY PACKET must be signed by the member and completed by his or her attending physician. The medical information will be reviewed by the RSA Medical Board, which will rule on your eligibility. If the termination is due to involuntary transfer of spouse, submit a copy of the transfer letter on company letterhead.

Applying for DROP Distribution - Participation Period Completed

1. Complete the REQUEST FOR DROP DISTRIBUTION AND ROLLOVER ELECTION form (RSA 10 D-D) required to authorize distribution of the DROP account balance. The election to receive either a lump-sum payment or to make a rollover will be made on this form. If you elect to have a lump-sum payment of your DROP account, the TRS will withhold 20% for federal income taxes. The form must be signed and notarized, but no employer certification is required. If you elect to rollover all or a portion of your DROP account, sign and have the form notarized before sending it to the Trustee of the eligible retirement plan you have elected to make your rollover to. The Trustee should mail the completed form to the TRS.
2. Complete the REQUEST FOR DROP TERMINATION PARTICIPATION PERIOD COMPLETED form (TRS 10 D-C). Complete the federal income tax withholding certificate. Sign and have the form notarized before sending it to your employing agency for them to certify your

employment. You and your employer will also have to complete the PEEHIP Insurance Authorization information on the reverse side of the form.

3. Send both the completed REQUEST FOR DROP DISTRIBUTION AND ROLLOVER ELECTION form and the REQUEST FOR DROP TERMINATION PARTICIPATION PERIOD COMPLETED form to the TRS. If electing a rollover, the Trustee will send the REQUEST FOR DROP DISTRIBUTION AND ROLLOVER ELECTION form to the TRS. Both forms must be completed and returned to the TRS at least 30 days prior to termination of employment, if possible.

Applying for DROP Distribution - Death During DROP Participation

1. The beneficiary must complete the APPLICATION FOR BENEFICIARY PAYMENT - DROP form (RSA-DROP BEN). The beneficiary will complete Part I, Part II, and Part III, sign and have the form notarized. The employer of the deceased member will complete Part IV and send the form to the TRS. A copy of the death certificate must accompany this form.
2. How the DROP account balance is distributed depends on whether the beneficiary is a surviving spouse or not. A non-spousal beneficiary may receive the distribution in a lump-sum payment, or make a direct rollover to an IRA created for that purpose. See **Section IV** of the **Special Tax Notice** for tax treatment of non-spousal beneficiaries.

If the beneficiary is a surviving spouse, the surviving spouse may elect to either have the full account balance paid directly to them less the 20% mandatory withholding on taxable portion of payment, or have all or a portion of the account balance rolled over into an eligible

retirement plan.

3. If you elect to rollover all or a portion of your DROP account, sign and have the form notarized before sending it to the Trustee of the eligible retirement plan you have elected to make your rollover to. The Trustee should mail the completed form to the TRS.

DROP Participation Period Completed - Will Continue Employment

Complete the REQUEST FOR DROP TERMINATION PARTICIPATION PERIOD COMPLETED/CONTINUED SERVICE form (RSA 10 D-CCE). Check the box indicating you will be continuing employment after you have completed the DROP participation period. Sign the form and have it notarized. Have your employer certify your employment and have them return the form to the TRS.

Once you terminate employment post-DROP:

1. Complete the REQUEST FOR DROP DISTRIBUTION AND ROLLOVER ELECTION form (RSA 10 D-D) required to authorize distribution of the DROP account balance. The election to receive either a lump-sum payment or to make a rollover will be made on this form. If you elect to have a lump-sum payment of your DROP account, the TRS will withhold 20% for federal income taxes. The form must be signed and notarized, but no employer certification is required. If you elect to rollover all or a portion of your DROP account, sign and have the form notarized before sending it to the Trustee of the eligible retirement plan you have elected to make your rollover into. The Trustee should mail the completed form to the TRS.
2. Complete the TERMINATION OF EMPLOYMENT OF CONTINUED SERVICE - Post DROP form (TRS 10 D-CT). Complete the federal income

tax withholding certificate. Sign and have the form notarized before sending it to your employing agency for them to certify your employment. You and your employer will also have to complete the PEEHIP Insurance Authorization information on the reverse side of the form.

3. Send both the completed REQUEST FOR DROP DISTRIBUTION AND ROLLOVER ELECTION form and the TERMINATION OF CONTINUED SERVICE - POST DROP form to the TRS. If electing a rollover, the Trustee will send the REQUEST FOR DROP DISTRIBUTION AND ROLLOVER ELECTION form to the TRS. Both forms must be completed and returned to the TRS at least 30 days prior to termination of employment, if possible.

Reemployment with the RSA after Withdrawal from Service

If any member who participated in DROP and withdrew from service becomes reemployed with either the TRS or TRS in a full-time capacity, his or her monthly benefit will be suspended. A benefit on this additional service will be calculated based on information in **Continued Service After the DROP Participation Period** on page 3. Please notify the TRS prior to being reemployed on a full-time basis.

Special Tax Notice Regarding RSA Payments

This notice explains how to continue deferring federal income tax on your retirement savings in the Retirement Systems of Alabama (RSA) and contains important information you will need before you decide how to receive your RSA benefits. To best suit your financial needs, consult your tax and/or financial advisor.

This notice is provided to you by the RSA because all

or part of the payment that you will soon receive from the RSA may be eligible for rollover by you or the RSA to a traditional IRA or an eligible employer plan. A rollover is a payment by you or the RSA of all or part of your benefit to another plan or IRA that allows you to continue to postpone taxation of that benefit until it is paid to you. Your payment cannot be rolled over to a Roth IRA, a SIMPLE IRA, or a Coverdell Education Savings Account (formerly known as an education IRA).

An eligible employer plan includes a plan qualified under Section 401(a) of the Internal Revenue Code, including a 401(k) Plan, Profit-sharing Plan, defined benefit plan, stock bonus plan, and money purchase plan; 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 (governmental 457 Plan).

An eligible employer plan is not legally required to accept a rollover. Before you decide to roll over your payment to another employer plan, you should find out whether the plan accepts rollovers and, if so, the types of distributions it accepts as a rollover. You should also find out about any documents that are required to be completed before the receiving plan will accept a rollover. Even if a plan accepts rollovers, it might not accept rollovers of certain types of distributions, such as after-tax amounts. If this is the case, and your distribution includes after-tax amounts, you may wish instead to roll your distribution over to a traditional IRA or to split your rollover amount between the employer plan in which you will participate and a traditional IRA. If an employer plan accepts your rollover, the plan may restrict subsequent distributions of the rollover amount or may require your spouse's consent for any subsequent distribution. A subsequent distribution from the plan that accepts your rollover may also be subject to different tax treatment than distributions from the RSA. Check with the administrator of the plan that is to receive your rollover prior to making the rollover.

Summary

There are two ways you may be able to receive a plan payment that is eligible for rollover:

1. *Direct Rollover*: Certain payments can be made directly to a traditional IRA that you establish or to an eligible employer plan that will accept it and hold it for your benefit; or
2. The payment can be *Paid to You*.

If you choose a *Direct Rollover*:

- ◆ Your payment will not be taxed in the current year, and no income tax will be withheld.
- ◆ You choose whether your payment will be made directly to your traditional IRA or to an eligible employer plan that accepts your rollover. Your payment cannot be rolled over to a Roth IRA, a SIMPLE IRA or a Coverdell Education Savings Account because these are not traditional IRAs.
- ◆ Your payment will be taxed later when you take it out of the traditional IRA or the eligible employer plan. Depending on the type of plan, the later distribution may be subject to different tax treatment than it would be if you received a taxable distribution from this plan.

If you choose to have a Plan payment that is eligible for rollover *Paid to You*:

- ◆ You will receive only 80% of the taxable amount of the payment, because the RSA is required to withhold 20% of that amount and send it to the IRS as income tax withholding to be credited against your taxes.
- ◆ The taxable amount of your payment will be taxed in the current year unless you roll it over. Under limited circumstances, you may be able to use special tax rules that could reduce the tax you owe.

- ◆ You can roll over all or part of the payment by paying it to your traditional IRA or to an eligible employer plan that accepts your rollover within 60 days after you receive the payment. The amount rolled over will not be taxed until you take it out of the traditional IRA or the eligible employer plan.
- ◆ If you want to roll over 100% of the payment to a traditional IRA or an eligible employer plan, you must find other money to replace the 20% of the taxable portion that was withheld. If you roll over only the 80% that you received, you will be taxed on the 20% that was withheld and that is not rolled over.

YOUR RIGHT TO WAIVE THE 30-DAY NOTICE PERIOD: Generally, neither a direct rollover nor a payment can be made from the RSA until at least 30 days after your receipt of this notice. Thus, after receiving this notice, you have at least 30 days to consider whether or not to have your withdrawal directly rolled over. If you do not wish to wait until this 30-day notice period ends before your election is processed, you may waive the notice period by making an affirmative election indicating whether or not you wish to make a direct rollover. Your withdrawal will then be processed in accordance with your election as soon as practical after it is received by the RSA.

I. Payments That Can and Cannot Be Rolled Over

Payments from the RSA may be *eligible rollover distributions*. This means that they can be rolled over to a traditional IRA or to an eligible employer plan that accepts rollovers. Payments from the RSA cannot be rolled over to a Roth IRA, a SIMPLE IRA or a Coverdell Education Savings Account. The RSA should be able to tell you whether your payment is an eligible rollover distribution. The following types of payments cannot be rolled over.

AFTER-TAX CONTRIBUTIONS: If you made after-tax contributions to the RSA, these contributions may be rolled into either a traditional IRA or to certain employer plans that accept rollovers of the after-tax contributions.

The following rules apply:

- a) Rollover into a Traditional IRA. You can roll over your after-tax contributions to a traditional IRA either directly or indirectly. The RSA should be able to tell how much of your payment is the taxable portion and how much is the after-tax portion. If you roll over after-tax contributions to a traditional IRA, it is your responsibility to keep track of, and report to the Service on the applicable forms, the amount of these after-tax contributions. This will enable the nontaxable amount of any future distributions from the traditional IRA to be determined. Once you roll over your after-tax contributions to a traditional IRA, those amounts cannot later be rolled over to an employer plan.
- b) Rollover into an Employer Plan. You can rollover after-tax contributions from an employer plan that is qualified under Code section 401(a) or a section 403(a) annuity plan to another such plan using a direct rollover if the other plan provides separate accounting from amounts rolled over, including separate accounting for the after-tax employee contributions and earnings on those contributions. You CANNOT roll over after-tax contributions to a governmental 457 plan. If you want to roll over your after-tax contributions to an employer plan that accepts these rollovers, you cannot have the after-tax contributions paid to you first. You must instruct the RSA to make a direct rollover on your behalf. Also, you cannot first roll over after-tax contributions to a traditional IRA and then roll over that amount

into an employer plan.

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 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.

CORRECTIVE DISTRIBUTIONS: A distribution that is made because legal limits on certain contributions were exceeded cannot be rolled over.

The RSA should be able to tell you if your payment includes amounts which cannot be rolled over.

II. Direct Rollover

A DIRECT ROLLOVER is a direct payment of the amount of your RSA benefits to a traditional IRA or an eligible employer plan that will accept it. You can choose a DIRECT ROLLOVER of all or any portion of your payment that is an eligible rollover distribution, as described in Part I above. 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 the traditional IRA or eligible employer plan. In addition, no income tax withholding is required for any taxable portion of your RSA benefits for which you choose a DIRECT ROLLOVER. The Plan might not let you choose a DIRECT ROLLOVER if your distributions for the year are less than \$200.

DIRECT ROLLOVER TO A TRADITIONAL IRA: You can open a traditional IRA to receive the DIRECT ROLLOVER. If you choose to have your payment made directly to

a traditional IRA, contact an IRA sponsor (usually a financial institution) to find out how to have your payment made in a DIRECT ROLLOVER to a traditional IRA at that institution. If you are unsure of how to invest your money, you can temporarily establish a traditional IRA to receive the payment. However, in choosing a traditional IRA, you may wish to make sure that the traditional IRA you choose will allow you to move all or a part of your payment to another traditional IRA at a later date, without penalties or other limitations. See IRS Publication 590, Individual Retirement Arrangements, for more information on traditional 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 has an eligible employer plan, and you want a DIRECT ROLLOVER to that plan, ask the Plan Administrator of that plan whether it will accept your rollover. An eligible employer plan is not legally required to accept a rollover. Even if your new employer's plan does not accept a rollover, you can choose a DIRECT ROLLOVER to a traditional IRA. If the employer plan accepts your rollover, the plan may provide restrictions on the circumstances under which you may later receive a distribution of the rollover amount or may require spousal consent to any subsequent distribution. Check with the Plan Administrator of that plan before making your decision.

CHANGE IN TAX TREATMENT RESULTING FROM A DIRECT ROLLOVER: The tax treatment of any payment from the eligible employer plan or traditional IRA receiving your DIRECT ROLLOVER might be different than if you received your benefit in a taxable distribution directly from RSA. 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 to a section 403(b) tax-sheltered annuity, a governmental 457 plan, or a traditional IRA in a DIRECT ROLLOVER, your benefit will no longer be eligible for that special treatment. See the sections below entitled "Additional 10% Tax If You Are

Under Age 59½" and "Special Tax Treatment If You Were Born Before January 1, 1936."

III. Payment Paid To You

If your payment can be rolled over (see Part I above) and the payment is made to you in cash, it is subject to a 20% federal income tax withholding on the taxable portion (state tax withholding may also apply). The payment is taxed in the year you receive it unless, within 60 days, you roll it over to a traditional IRA or an eligible employer plan that accepts rollovers. If you do not roll it over, special tax rules may apply.

Income Tax Withholding

MANDATORY WITHHOLDING: If any portion of your payment can be rolled over under Part I above and you do not elect to make a DIRECT ROLLOVER, the Plan is required by law to withhold 20% of the taxable amount. This amount is sent to the IRS as federal income tax withholding. *For example*, if you can roll over a taxable payment of \$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 income tax return for the year, unless you make a rollover within 60 days (see SIXTY-DAY ROLLOVER OPTION below) you must report the full \$10,000 as a taxable payment from the Plan. You must report the \$2,000 as tax withheld, and it will be credited against any income tax you owe for the year. There will be no income tax withholding if your payments for the year are less than \$200.

VOLUNTARY WITHHOLDING: If any portion of your payment is taxable but cannot be rolled over under Part I above, the mandatory withholding rules described above do not apply. In this case, you may elect not to have withholding apply to that portion. If you do nothing, an amount will be taken out of this portion of your payment for federal income tax withholding. To elect out of withholding, ask the RSA for the election form and related information.

SIXTY-DAY ROLLOVER OPTION: If you receive a payment that can be rolled over under Part I above, you can still decide to roll over all or part of it to a traditional IRA or to an eligible employer plan that accepts rollovers. If you decide to roll over, *you must contribute the amount of the payment you received to a traditional IRA or eligible employer plan within 60 days after you receive the payment.* The portion of your payment that is rolled over will not be taxed until you take it out of the traditional IRA or the eligible employer plan.

You can roll over up to 100% of your payment that can be rolled over under Part I above, including an amount equal to the 20% of the taxable portion that was withheld. If you choose to roll over 100%, you must find other money within the 60-day period to contribute to the traditional IRA or the eligible employer plan to replace the 20% that was withheld. On the other hand, if you roll over only the 80% of the taxable portion that you received, you will be taxed on the 20% that was withheld.

Example: The taxable portion of your payment that can be rolled over under Part I above is \$10,000, and you choose to have it paid to you. You will receive \$8,000, and \$2,000 will be sent to the IRS as income tax withholding. Within 60 days after receiving the \$8,000, you may roll over the entire \$10,000 to a traditional IRA or an eligible employer plan. To do this, you roll over the \$8,000 you received from the Plan, and you will have to find \$2,000 from other sources (your savings, a loan, etc.). In this case, the entire \$10,000 is not taxed until you take it out of the traditional IRA or an eligible employer plan. If you roll over the entire \$10,000, when you file your income tax return you may get a refund of part or all of the \$2,000 withheld.

If, on the other hand, you roll over only \$8,000, the \$2,000 you did not roll over is taxed in the year it was withheld. When you file your income tax return, you may get a refund of part of the \$2,000

withheld. (However, any refund is likely to be larger if you roll over the entire \$10,000.)

ADDITIONAL 10% TAX IF YOU ARE UNDER AGE

59 ½: If you receive a payment before you reach age 59 ½ and you do not roll it over, then, in addition to the regular income tax, you may have to pay an extra tax equal to 10% of the taxable portion of the payment. The additional 10% tax generally does not apply to (1) payments that are paid as equal (or almost equal) over your life or life expectancy (or your and your beneficiary's lives or life expectancies), (2) payments that are paid from an eligible employer plan after you separate from service with your employer during or after the year you reach age 55, (3) payments that are paid because you retire due to disability, (4) payments that are paid directly to the government to satisfy a federal tax levy, (5) payments that do not exceed the amount of your deductible medical expenses. These exceptions may be different for distributions from a traditional IRA. See IRS Form 5329 for more information on the additional 10% tax.

The additional 10% tax does not apply to distributions from RSA-1 or any other governmental 457 Plan, except to the extent the distribution is attributable to an amount you rolled over to the governmental 457 Plan (adjusted for investment returns) from another type of eligible employer plan or IRA. Any amount rolled over from RSA-1 to another type of eligible employer plan or to a traditional IRA will be subject to the additional 10% tax if it is distributed to you before you reach age 59½, unless an exception applies.

SPECIAL TAX TREATMENT IF YOU WERE BORN BEFORE

JANUARY 1, 1936: If you receive a payment from a plan qualified under section 401(a) or a section 403(a) annuity plan that can be rolled over under Part I and you do not roll it over to a traditional IRA or an eligible employer plan, the payment will be taxed in the year you receive it. However, if the payment qualifies as a "lump-sum distribution," it may be eligible for special

tax treatment. A lump-sum distribution is a payment, within one year, of your entire balance under the Plan (and certain other similar plans of the employer) that is payable to you after you have reached age 59 ½ or because you have separated from service with your employer. 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 the year in which you received the distribution. The special tax treatment for lump-sum distributions that may be available to you is described below.

TEN-YEAR AVERAGING: If you receive a lump-sum distribution and you were born before January 1, 1936, you can make a one-time election to figure the tax on the payment by using “10-year averaging” (using 1986 tax rates). Ten-year averaging often reduces the tax you owe.

CAPITAL GAIN TREATMENT: If you receive a lump-sum distribution and you were born before January 1, 1936, and you were a participant in the RSA before 1974, you may elect to have the part of your payment that is attributable to your pre-1974 participation in the RSA 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 this special tax treatment only once in your lifetime, and the election applies to all lump-sum distributions that you receive in that same year. You may not elect this special tax treatment if you rolled amounts into the RSA 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 the RSA (or certain other similar plans of the employer), you cannot use this special averaging treatment for later payments from the RSA. If you roll over your payment to a traditional IRA, governmental 457 plan, or 403(b) tax-sheltered annuity, you will not be able to use special tax treatment for later payments

from that IRA, plan, or annuity. Also, if you roll over only a portion of your payment to a traditional IRA, governmental 457 plan, or 403(b) tax-sheltered annuity, this special tax treatment is not available for the rest of the payment. See IRS Form 4972 for additional information on lump-sum distributions and how you elect the special tax treatment.

IV. Surviving Spouses and Other Beneficiaries

In general, the rules summarized above that apply to payments to employees also apply to payments to beneficiaries of employees.

If you are a surviving spouse or another beneficiary, your payment is generally not subject to the additional 10% tax described in Part III above, even if you are younger than age 59½.

If you are a beneficiary other than a surviving spouse, you may have the payment paid to you, or you may choose a DIRECT ROLLOVER, but only to an Individual Retirement Account or Individual Retirement Annuity established for that purpose.

If you are a surviving spouse or another beneficiary, you may be able to use the special tax treatment for lump-sum distributions. If you receive a payment because of the 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 5 years of participation in the RSA.

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. Therefore, you may want to consult the RSA or a professional tax advisor before you take a payment of your benefits from the RSA. Also, 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 800-TAX-FORMS.



The Teachers' Retirement System of Alabama

P.O. Box 302150

Montgomery, Alabama 36130-2150