Washington State Deferred Compensation Program Special Tax Notice Regarding Plan Payments for Governmental 457(b) Plans

This Notice explains how you can continue to defer federal income tax on your retirement savings in the Washington State Deferred Compensation Program (DCP) and contains important information you will need before you decide how to receive your DCP benefits.

This Notice is provided to you by the Washington State Deferred Compensation Program to make you aware that when you receive payment from your DCP account, all or part of the payment may be eligible for rollover to an Individual Retirement Account (IRA), Roth IRA or an eligible employer plan. A rollover is a payment by you or DCP, for all or part of your benefit, to another plan or IRA that allows you in some cases to continue to postpone taxation of that benefit until it is paid to you. Your payment cannot be rolled over to 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. Your payment also can be rolled over to a section 408A Roth IRA subject to the same limits that apply to rollovers from a traditional IRA to a Roth IRA (i.e., for tax years prior to January 1, 2010, your adjusted gross income cannot exceed $100,000 and you must not be married filing separately).

An eligible employer plan is not legally required to accept a rollover. Before you decide to roll over your payment to another eligible 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. If this is the case, you may wish instead to roll your distribution over to an IRA or to split your rollover amount between the eligible employer plan in which you will participate and an IRA. If an eligible 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 DCP. Check with the administrator of the plan that will receive your rollover prior to making the rollover.

If you have additional questions after reading this notice, you can contact a DCP Customer Service Representative at 888-327-5596.

Summary

There are two ways you may be able to receive DCP payments that are eligible for rollover:

1. Certain payments can be made directly to a an IRA that you establish or to an eligible employer plan that will accept it and hold it for your benefit **("direct rollover")**; or
2. The payment can be **paid to you.**

If you choose a **direct rollover:**

- Except for a Roth IRA, 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 SIMPLE IRA or a Coverdell Education Savings Account.
- Your payment will be taxed later when you take it out of a traditional IRA or an 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 DCP.
- Your distribution will be included in your taxable income if your payment is rolled over to a Roth IRA. DCP is not responsible for assuring your eligibility to make a rollover to a Roth IRA. You should consult your tax adviser if you are interested in rolling over your distribution to a Roth IRA.

If you choose to have your DCP payments that are eligible for rollover **paid to you:**

- You will receive only 80 percent of the taxable amount of the payment because DCP is required to withhold 20 percent 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 to a traditional IRA or eligible employer plan.
- You can roll over all or part of the payment by paying it to your IRA or to an eligible employer plan that accepts your rollover within 60 days after you receive the payment. Except for a Roth IRA, 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 percent of the payment to a traditional IRA or an eligible employer plan, **you must find other money to replace the 20 percent of the taxable portion that was withheld.** If you roll over only the 80 percent that you received, you will be taxed on the 20 percent that was withheld and that is not rolled over.

You may also elect a **direct rollover** for part of a payment that is eligible for rollover and elect to have the remainder **paid to you.** However, this option is available only if your total payment is greater than $200 and you elect a **direct rollover** of at least $200.

Your Right to Waive the 30-Day Notice Period

Generally, neither a direct rollover or a payment can be made from DCP 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 (generally within seven business days) by DCP.

More Information

Payments that can and cannot be rolled over

Payments from DCP may be "eligible rollover distributions." This means that they can be rolled over to an IRA or to an eligible employer plan that accepts rollovers. Payments from DCP cannot be rolled over to a SIMPLE IRA or a Coverdell Education Savings Account. DCP can tell you whether your payment is an eligible rollover distribution. Non-spouse beneficiaries are only allowed to roll over to an IRA that has been properly established as an Inherited IRA.

The following types of payments <u>cannot</u> 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.

Required minimum payments

Beginning when you reach age 70½ or retire, whichever is later, a certain portion of your payment cannot be rolled over because it is a "required minimum payment" that must be paid to you.

Unforeseeable emergency distributions

A distribution for an unforeseeable emergency cannot be rolled over.

Distributions of excess contributions

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

DCP can tell you if your payment includes amounts which cannot be rolled over.

Direct rollover

A **direct rollover** is a direct payment of the amount of your DCP benefits to an 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 "Payments that can and cannot be rolled over" on page 21 in the *Distribution Booklet*. Except for a direct rollover to a Roth IRA, you are not taxed on any taxable portion of your payment for which you choose a direct rollover until you later take it out of the traditional IRA or eligible employer plan. In addition, no income tax withholding is required for any taxable portion of your Plan benefits for which you choose a **direct rollover**. You may not choose a **direct rollover** if your distributions for the year are less than $500.

Direct rollover to a an IRA

You can open an IRA to receive the direct rollover. If you choose to have your payment made directly to an IRA, contact an IRA sponsor (usually a financial institution) to find out how to have your payment made in a direct rollover to an IRA at that institution. If you are unsure of how to invest your money, you can temporarily establish an IRA to receive the payment. However, in choosing an IRA, you may wish to make sure that the IRA you choose will allow you to move all or a part of your payment to another IRA 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 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 an 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.

Direct rollover of a series of payments

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

Change in tax treatment resulting from a direct rollover

The tax treatment of any payment from the eligible employer plan or an IRA receiving your direct rollover might be different than if you received your benefit in a taxable distribution directly from the Plan.

Permissive Service Credit Purchases

If you elect to directly transfer all or part of your DCP account balance for the purpose of purchasing service credit under a governmental defined benefit plan, the plan-to-plan transfer will not be subject to tax reporting. You will not pay income taxes on the transferred amount until you eventually receive a pension benefit distribution from the governmental defined benefit plan.

Payment paid to you

If your payment can be rolled over (see "Payments that can and cannot be rolled over" on page 21 in the *Distribution Booklet*) and the payment is made to you in cash, it is subject to 20 percent 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 "Payments that can and cannot be rolled over" (see page 21 in the *Distribution Booklet*) and you do not elect to make a direct rollover, DCP is required by law to withhold 20 percent 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 DCP 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 to a traditional IRA or eligible employer plan (see "Sixty-Day Rollover Option" below), you must report the full $10,000 as a taxable payment from DCP . 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 "Payments that can and cannot be rolled over" on page 21 in the *Distribution Booklet*, 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 your payment for federal income tax withholding. If you are receiving a lump sum payment that cannot be rolled over (e.g., a hardship withdrawal) and you do nothing, 10 percent will be taken out. If you are receiving installment payments of ten years or more (or annuity payments) and you do nothing, withholding will be taken out as if you are married and claim three allowances. To change or elect out of withholding, complete and return Form W-4P.

Sixty-day rollover option

If you receive a payment that can be rolled over under "Payments that can and cannot be rolled over" on page 21 in the *Distribution Booklet*, you can still decide to roll over all or part of it to an 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 an IRA or eligible employer plan within 60 days after you receive the payment.** Unless you roll over your distribution to a Roth IRA, 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.

If you want to roll over a payment you received to a traditional IRA or eligible employer plan, you can roll over up to 100 percent of your payment that can be rolled over under "Payments that can and cannot be rolled over" (see page 21 in the *Distribution Booklet*), including an amount equal to the 20 percent of the taxable portion that was withheld. If you choose to roll over 100 percent, you must find other money within the 60-day period to contribute to the IRA or the eligible employer plan, to replace the 20 percent that was withheld. On the other hand, if you roll over only the 80 percent of the taxable portion that you received, you will be taxed on the 20 percent that was withheld.

Example: Your payment that can be rolled over under "Payments that can and cannot be rolled over" (see page 21 in the *Distribution Booklet*) 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 an IRA or an eligible employer plan. To do this, you roll over the $8,000 you received from DCP, 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.)

*Note: Amounts rolled into a Roth IRA are taxed in the year the amount is rolled over.

Additional 10 percent tax may apply to certain distributions

Distributions from DCP are generally not subject to the additional 10 percent tax that applies to pre-age 59½ distributions from other types of plans. However, any distribution from DCP that is attributable to an amount you rolled over to DCP (adjusted for investment returns) from another type of eligible employer plan or IRA amount is subject to the additional 10 percent tax if it is distributed to you before you reach age 59½, unless an exception applies. Exceptions to the additional 10 percent tax generally include (1) 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), (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 are paid to a surviving spouse, another beneficiary, or an alternate payee under a qualified domestic relations order, or (6) 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 and IRS Notice 2007-07 for more information on the additional 10 percent tax.

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

Surviving spouses, alternate payees, and other beneficiaries

In general, the rules summarized above that apply to payments to employees also apply to payments to surviving spouses of employees and to spouses or former spouses who are "alternate payees." You are an alternate payee if your interest in DCP results from a domestic relations order, which is an order issued by a court, usually in connection with a divorce or legal separation.

You may choose to have a payment that can be rolled over, as described in "Payments that can and cannot be rolled over" (see page 21 in the *Distribution Booklet*), paid in a direct rollover to an IRA or to an eligible employer plan or paid to you. If you have the payment paid to you, you can keep it or roll it over yourself to an IRA or to an eligible employer plan. Thus, you have the same choices as the employee.

If you are a beneficiary other than a surviving spouse or an alternate payee and receive a distribution, you can choose to be paid in a direct rollover to a traditional or Roth IRA, which will be treated as an inherited IRA subject to the minimum distribution rules applicable to beneficiaries. You cannot choose a direct rollover to an eligible employer plan, and you cannot roll over the payment yourself.

How to Obtain Additional Information

This notice summarizes only the federal 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 with DCP or a professional tax adviser before you take a payment of your benefits from DCP. Also, you can find more specific information on the tax treatment of payments from eligible 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 Web Site at *www.irs.gov,* or by calling 800-TAX-FORMS.