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Reply To: Section 445

REFUND TAX INFORMATION

RETAIN FOR FUTURE REFERENCE

The following consists of summarized tax information and is provided in accordance with Section 402(f) of the Internal Revenue Code. **CalPERS cannot provide specific information or tax advice. Please see your tax consultant, the Internal Revenue Service or the State Franchise Tax Board. For additional information concerning rollovers, consult the appropriate financial institution of your choice.**

Rollovers – An “eligible rollover distribution” consists of the taxable portion of a refund of your contributions, including interest, due to a separation from all CalPERS-covered employment. You may avoid current taxation on the taxable amount of an eligible rollover distribution by rolling over that amount to an individual retirement arrangement (IRA) or another qualified employer retirement plan that accepts rollover contributions. A rollover may be accomplished in one of the following ways:

- 1) Direct Rollover** – You may request CalPERS transfer the taxable amount of the distribution to a special IRA or a qualified retirement plan that accepts rollovers. The amount to be rolled over must be at least \$500.00. Taxes will be reportable when you take the money out of the IRA or other qualified plan.
- 2) Regular Rollover** – You may take an in-hand distribution and, not later than 60 days after you receive the distribution, transfer all or a portion of the taxable portion of the distribution to an IRA or qualified plan that accepts rollovers. Taxes will be reportable when you take the money out of the IRA or other qualified plan.

Even if you plan to roll over the taxable portion of the eligible distribution, **unless you elect a “direct rollover”, you will only receive 80% of the distribution.** Federal tax rules require CalPERS to automatically deduct 20% federal tax withholding from the taxable portion of your refund if it is over \$200.00.

If you wish to make the “regular rollover” for the full 100% of your refund, you will have to make up the 20% difference out-of-pocket. You will also be taxed on the 20% that was withheld. When filing your individual tax return you then can get a refund of the amount withheld to the extent you have no further tax liability.

Early distributions from a qualified retirement plan are subject to an early withdrawal penalty tax of 10% federal and 2 ½% state on the taxable portion of the distribution, if received prior to age 59 ½ unless an exception applies, PLUS any income tax due on the distribution.

Please be aware, not all distributions are eligible to be rolled over. Any distribution that is part of a series of substantially equal periodic payments made at least annually under a life annuity, over life expectancy or over a specified period of 10 or more years is ineligible to be rolled over. Also ineligible for rollover treatment is the amount of a distribution that is necessary to satisfy the minimum distribution requirements that apply after you separate from employment or turn age 70 ½, **whichever occurs later.**

PERS02M0325 (7/07)

EXCEPTIONS TO THE ADDITIONAL TAX – There are some instances where an individual will be exempt from the early withdrawal penalty tax of 10% federal and 2 ½% state even if they take an early distribution from a qualified retirement plan. These exceptions are as follows: 1) receipt of a CalPERS service or disability retirement benefit, paid as a monthly allowance over your/your beneficiary's life, 2) a lump sum distribution, if made to a beneficiary because of your death, 3) a lump sum distribution made to you because of your separation from service after attaining age 55 or after becoming disabled. (Because CalPERS cannot verify that a lump sum distribution was made due to disability, you should contact the IRS directly to apply for this exception.) The 10% federal penalty tax will be waived when a lump sum distribution is made because of your separation from service as a safety member providing police protection, firefighting service or emergency medical service. The separation of service must have occurred during or after the calendar year in which you attained age 50.

FIVE-YEAR AND TEN-YEAR AVERAGING/CAPITAL GAIN – If you receive a lump sum distribution after you are age 59 ½, you may be able to make a one-time election to figure the tax on the payment by using “**5-year averaging**”. To qualify for 5-year averaging, you must be at least 59 ½ and have participated in CalPERS (the plan making the distribution) for no less than 5 years before the year the distribution is made.

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). Only one election is available to an individual, and if made, eliminates the ability to elect 5-year averaging and capital gain treatment after attaining age 59 ½. However, any 10-year averaging election made prior to January 1, 1987, and before attaining age 59 ½, does not count toward your one election.

If you were born prior to January 1, 1936 and you receive a lump sum distribution, any pre-1974 CalPERS contributions you paid (if applicable) may be taxed as long-term “**capital gain**” at the rate of 20%.

CALIFORNIA STATE TAX WITHHOLDING – If you elect to receive a lump sum distribution of your contributions, California state income tax withholding is optional. State tax, if withheld, is 2% of the taxable portion of the refund. An individual also has the right to revoke or change their choice prior to the mailing of their warrant.

For those California residents who do not make a choice, 2% will be **automatically** withheld for state tax.

For individuals **who reside outside of California**, no state tax will be withheld unless specifically requested. Please be aware that you may still owe California state taxes.

Publications are available from the Internal Revenue Service which provides specific information on special tax treatment on lump sum distributions. If you have state tax liability questions, contact the California Franchise Tax Board.