

WHAT'S TAXABLE AND NON-TAXABLE?

As you elect a form of benefit, you may want to consider which portions of your benefit may be taxable or non-taxable. You may contact United Benefits Group to request information on whether a distribution is taxable.

- If you are not vested when you terminate your employment, the calculation of your taxable and non-taxable benefits is easy. Your personal contributions are non-taxable (because they were after-tax contributions), and the interest you receive is taxable.
- If you are vested when you terminate your employment, the calculation of the taxable and non-taxable portions of your refund is more complicated. This can best be illustrated with an example, which assumes that you have elected Option B as described in prior sections:

EXAMPLE: John, a participant with 8 years of Creditable Service in the Plan, terminates employment at age 36, and selects Option B. His personal contributions are non-taxable and equal \$3,000. The interest on his contributions totals \$500, making a total distribution of \$3,500. His monthly plan benefit at Normal Retirement Date is \$270. The employer-paid portion of his monthly benefit will be \$196 per month at Normal Retirement Date after he has received a distribution of his contributions and interest. According to tables, his total monthly benefit has a value of \$9,898.20 at the date of his distribution. Per government regulations, the non-taxable portion of his \$3,500 distribution will be calculated like this:

$$\begin{array}{rcccccc}
 \$3,000 & \div & \$9,898.20 & = & 30.3\% & \times & \$3,500 & = & \$1,060.50 \\
 \text{Personal} & & \text{Total} & & & & \text{Distrib.} & & \text{Non-} \\
 \text{Contrib.} & & \text{Present} & & & & & & \text{Taxable} \\
 & & \text{Value} & & & & & & \text{Portion}
 \end{array}$$

So, when John receives the refund of his personal contributions plus interest, only \$1,060.50 of the \$3,500 total distribution will

be non-taxable. But John made total after-tax personal contributions of \$3,000, so what happens to the other \$1,939.50?

Answer – The remaining \$1,939.50 of after-tax contributions will be recovered by John on a pro-rated basis when he collects his Termination Annuity. To illustrate, let's say he elects to commence his monthly benefit at age 65. Based on the IRS method in effect in 2009, we assume that a 65-year old like John will receive 260 payments before his death. Therefore, we divide John's remaining after-tax contributions of \$1,939.50 by 260. The result is \$7.46, which means that of the first 260 monthly checks of \$196 each that John receives, \$7.46 will be non-taxable. If he does not collect 260 checks before his death, his survivors may claim the unrecovered non-tax contributions as a loss on his final tax return.

OPTION A OR OPTION B? TAXES MAKE A DIFFERENCE!

You may recall that if you are vested and terminate employment prior to becoming eligible for at least Early Retirement, you may elect Option A or Option B. Your selection may be influenced by tax laws that affect distributions from pension plans. Generally, taxes only need to be paid when a portion or all of your distribution is taxable. For example, the taxable portion of your distribution may be subject to an automatic 20% withholding for federal income tax and a 10% federal penalty tax for early withdrawal. Here are some things you should know before you decide between Option A and Option B.

Option A – If you choose Option A, you defer all taxation issues until retirement age. Since you leave your contributions and interest in the Plan, there is no distribution and thus no immediate taxation.

Option B – If you select Option B, you have another choice to make: whether or not to roll

the taxable portion of your distribution into an Individual Retirement Account (IRA) or another qualified pension plan:

- If you decide not to roll the taxable portion of your distribution into an IRA (in other words, you decide to take and keep the distribution), you will receive a check that equals 100% of the non-taxable portion of your distribution plus 80% of the taxable portion. The other 20% of the taxable portion is automatically withheld for federal income tax. In addition, the taxable portion is also subject to a 10% penalty tax for early withdrawal. Also, some States require State tax withholding if federal taxes are withheld.
- If you decide to roll over the taxable portion of your distribution to a traditional IRA, you also have a choice of whether to roll over the non-taxable portion. If you elect not to roll over the non-taxable portion, it will be paid directly to you and it is not subject to regular taxation or penalty taxes. If you elect to roll over the non-taxable portion, it will be rolled over with the taxable portion. In any event, you will receive one rollover check for any taxable amounts you elect to roll over and one rollover check for any non-taxable amounts you elect to roll over. You must then forward any rollover checks to the qualified plan or IRA of your choice. As is true with Option A, this rollover will result in you owing no taxes until you begin receiving benefits.
- If you decide to roll over your distribution to a Roth IRA, however, you will be taxed on the taxable portion of your distribution at the time of the rollover.

The explanations above are generalizations. There is insufficient room in this booklet to describe all the ways that the tax laws may affect your distribution. Additionally, the tax laws change often, which may make the information in this booklet obsolete by the time you read it. For these reasons, we strongly suggest that you consult with a tax advisor before making decisions about the payment of your benefits. At the least, you should carefully read the special tax notice that accompanies your payment option election form.

Upon request, the Plan will furnish an estimate of your benefits, including an analysis of the taxable and non-taxable amounts of an Option B distribution.