



Lump Sum Distributions

The Lump Sum Distribution analysis compares various options that may be used to deal with lump sum amounts available for distribution from qualified Defined Contribution or Defined Benefit plans. This calculator

- recognizes when large lump sum distributions are likely to increase the taxpayer's tax bracket;
- automatically calculates "substantial equal periodic payments" to avoid the 10% penalty tax for distributions made before age 59½;
- automatically calculates Required Minimum Distributions on amounts held in an IRA or other plan past age 70½;
- correctly handles 10-year forward averaging, capital gains treatment of pre-1974 contributions, non-taxable distributions, state and local taxes, and other important details; and
- includes an option to convert to a Roth IRA.

Similar rules apply to many different kinds of tax-qualified retirement plans. Note, however, that rules vary somewhat, sometimes in important ways, for different types of plans. These differences are reflected in the RetirementWorks® system.

When to Use This Calculator

The Lump Sum Distribution Comparison will normally be used when a plan owner or participant first becomes eligible for a lump sum distribution – usually at retirement or when changing jobs for any other reason. Since in virtually all cases the system will demonstrate that the individual is much better off keeping his/her money tax-sheltered, this can be a great way to conserve assets in a plan. Of course, if someone has been doing this and is later tempted to withdraw his or her funds, this calculator can be used at that time as well.

Since this calculator is relatively sophisticated, taking into account unusual factors such as unpaid loans, after-tax contributions, and net unrealized appreciation on employer securities, it can be used for almost any plan that permits lump sum distributions.



RetirementWorks®

The screenshot shows the 'Lump Sum Distributions' window in RetirementWorks. The interface is organized into several sections:

- Header:** RetirementWorks® logo and menu (File, Print, Calculations, Windows, Help).
- Input Fields:** Name, Date of birth (mm/dd/yyyy), Tax year (dropdown: January to December), Tax Filing Status (dropdown: Married Filing Jointly), Estimated taxable income (EXCLUDING this distribution) for the current tax year: \$.
- Section: Distributable Amount**
 - Type of plan: dropdown (401(k) / 401(a) / Misc. def. contr.)
 - Date of distribution (mm/dd/yyyy):
 - Total distribution amount: \$
 - Net unrealized apprec. on employer securities: Basis: \$, Market value: \$
 - Check if 5- or 10-year averaging, or capital gains treatment of pre-1974 amounts has EVER been used
- Section: Distribution Options (choose one or more)** (Gray panel)
 - Lump Sum
 - Joint Life Annuity
 - IRA Rollover
 - Single Life Annuity
 - Ten-year Forward Averaging
 - Partial IRA Rollover (balance in Lump Sum)
 - Rollover with conversion to Roth IRA
 - Click here to enter or change distribution option data
- Section: Assumptions**
 - Pre-tax rate of return on plan investments: 8.00 %
 - Pre-tax rate of return on alternative investments: 8.00 %
 - State + local tax rate on pension income: %
 - State + local tax rate on ordinary income: %
 - State + local tax rate on capital gains: %
 - General inflation rate (applied to tax tables): 2.50 %
 - Annual rate of increase in taxable income (excluding distributions from this plan): %
 - Next year's estimated taxable income, to be used as a base for future inflation (optional): \$
- Footer:** Close button, Version 2.26A expires 09/30/01

How to Use This Calculator

The main input screen is in four sections. Start at the top of the input screen and work your way down. As you do so, certain fields and certain options will be enabled or disabled, according to what choices you make above. This will guide you in your inputs. When you get to the options in the gray panel in the middle of the screen, a detail screen will open up. You can make further selections on that screen, and add the details that apply to each option. When you are done specifying the options, click the Close button on the detail screen, and you will return to the main screen, where you can complete the items in the bottom section. You can always get back to the detail screen, if you want to, by clicking on the words "Click here to enter or change distribution option data" in the gray panel.



RetirementWorks®

Note that while seven distribution options are listed, the system will illustrate no more than six at one time on a Comparison report, because of space limitations on the output pages. You may select all seven for a Detail report, however. (More about these report options, below.)

Use the detailed instructions that follow, or press the <F1> key at any time during the input process to obtain on-line Help.

When you have entered all the information required, use the Print menu options to preview or print the report(s) for the fund owner. You can preview/print a Comparison report, which shows a side-by-side comparison of the options you have elected to illustrate, or you can preview/print the Detail reports, which provide a separate page for each option. The Comparison report shows only the annual estimated tax and closing balances for each option. The Detail reports show much more information, the particulars of which vary for each option. You may also elect to export the comparison data to an Excel spreadsheet (automatically named LumpSum.XLS).



Detailed Input Instructions

Name

Enter the name of the fund owner as it should appear on the printed report.

Date of birth (mm/dd/yyyy)

Enter the fund owner's date of birth in mm/dd/yyyy format.

Tax year

Select the fund owner's tax year. For most people, the tax year is the same as the calendar year, so the system defaults to "January to December". You may select a different option, however, when it is appropriate.

Tax Filing Status

Select the correct filing status that the fund owner is expected to use on his or her federal income tax return. This matters because the system will be performing tax calculations using actual (or projected) income tax rates which differ depending on filing status.

Estimated taxable income (EXCLUDING this distribution) for the current tax year

Enter the amount of ordinary taxable income (i.e. after deductions and exemptions) that the fund owner expects to have during the tax year in which he or she is eligible for the lump sum withdrawal. Include all ordinary income EXCEPT the lump sum withdrawal itself. The lump sum amount is excluded because the system will calculate the taxes, which will differ depending upon the distribution option selected. Also exclude long-term capital gains or other income subject to special taxes.

It is important to make a reasonable guess at this value, though it will seldom be



known precisely. Leaving it at zero will severely underestimate the taxes associated with the qualified plan distribution.

Type of plan

Select the appropriate plan type from the pull-down list:

- **401(k) / 401(a) / Misc. def. contr.** This category includes any Defined Contribution plans not listed in the other categories below.
- **403(b)** This category includes only 403(b) plans, which are also known as tax-sheltered annuities or tax-deferred annuities, whether they are actually funded with annuities, mutual funds, or other financial products.
- **IRA / Simple IRA / SEP IRA** This category covers any kind of IRA plan subject to the rules in question. Note, however, that Roth IRA plans are NOT subject to these rules.
- **457 Plan** This category covers all Section 457 plans.
- **Defined Benefit** This category covers all Defined Benefit plans, including "cash balance" plans, for which a lump sum option is permitted.

It is important to indicate the correct type of plan, since different plans follow somewhat different rules under IRS regulations.

Non-qualified retirement plans (other than Section 457 plans), and Roth IRAs are not subject to the distribution rules that apply to 401(k) plans, IRAs, 403(b) plans and the other plans listed above. Do not use this software for those plans.

Date of distribution (mm/dd/yyyy)

Enter the date, in mm/dd/yyyy format, on which the fund owner is eligible for the lump sum distribution. If there is an extended period of eligibility, enter the date on which the lump sum distribution is most likely to be made.

Total distribution amount

Enter the gross amount of the lump sum distribution. Do not exclude any portion of it. For



example, do NOT exclude amounts that may be withheld for income taxes and do NOT exclude amounts that represent pre-tax contributions.

Total after-tax contributions

Enter the amount of any distribution that represents after-tax contributions to the plan. Only include the actual amount of the contribution, not any interest or other earnings attributable to the after-tax contributions. Only include after-tax contributions that are part of the current distribution amount; do NOT include any after-tax contributions that have already been withdrawn or transferred out of the plan.

Cumulative prior PS-58 costs

This field does not apply to most plans. However, if life insurance is, or formerly was, used to help fund the plan, a portion of the plan assets will have been used to provide a life insurance death benefit. These amounts, which differ each year, are taxable during the years that they apply. Since they were taxed in those years, they are not taxable when the distribution is made. If you have a record of these amounts, which are called "PS-58 costs" because that is the name of the government table which defines what the death benefit costs are, you should total them up and enter the amount in this field. Doing so will tend to reduce the taxes due on the distribution.

Total prior loans treated as taxable income

You are required to make an entry in this field if your plan permits loans, if you have taken advantage of the loan provision, and if, because of late repayment, the loan became taxable income to you. If you have already paid the taxes on the loan income, it is not taxable again. Only include in this field taxable amounts that you actually did repay. Any former loans that were NOT repaid and are NOT included in the "Total distribution amount" field should not be entered here.

Please note that amounts entered in this field cannot be rolled over into an IRA. If you select an "IRA Rollover" as a distribution option, prior loan amounts treated as taxable income will be forced out of a 401(k), 401(a) or Defined Contribution plan as immediate (though non-taxable) distributions. If the original plan is an IRA, 403(b) or 457 plan, these amounts will be assumed to be retained in the original plan, and no immediate withdrawal is forced. In the case of a "Rollover with conversion to Roth IRA" option, the prior loan amounts are always forced out (although this fact may be disguised by the need to take additional funds out to pay taxes due



on the Roth conversion anyway).

Net unrealized apprec. on employer securities: Basis \$_____ Market value \$_____

This field is applicable if employer securities (usually stock or stock options) are included in plans sponsored by for-profit employers.

Enter the cost basis of the securities in the first field, and the market value in the second. The difference between the two is the Net Unrealized Appreciation (NUA), an amount which is taxed as a capital gain rather than as ordinary income, provided that the securities undergo a transfer-in-kind to a taxable account. Alternatively, they could be transferred to an IRA Rollover account, but in that case they would be taxable at ordinary tax rates when they are withdrawn.

In the case of a Roth IRA option, NUA is assumed NOT to be rolled over in to the IRA in order to preserve its capital gains tax treatment. Under all other options, NUA is either distributed or not, as are the other funds in the plan, the only difference being the tax treatment of the NUA amount.

Check if 5- or 10-year averaging, or capital gains treatment of pre-1974 amounts has EVER been used

This field applies, and is available, only for persons born before 1936. Such individuals may use 10-year forward averaging or may take capital gains treatment of portions of a lump sum distribution. These options can only be used once in a lifetime. If any of these options, including 5-year forward averaging (which, starting in 2000, is no longer permitted) have ever been used by this fund owner for any plan, none may be used later for any plan. They may be used simultaneously, however, if distributions are made from multiple plans.

Check this box if any of these options has ever been used. The system will then suppress any input options or internal calculations that might take further advantage of these options.

Distribution Options

Up to seven options may be illustrated when you run a detail report, while six options may be illustrated when you run a comparison report. However, you may use as few as one option. Any combination of options is allowed. Click on the check box next to each option you want to turn on.



The seven available options are:

- **Lump Sum.** This option withdraws the full distribution amount on the distribution date, without using any forward averaging option, if available. If the distribution would be an early distribution subject to the 10% penalty tax, the detail screen will provide the option of having the system automatically calculate "substantially equal periodic payments" under Internal Revenue Code section 72(t) in order to avoid the penalty.
- **Single Life Annuity.** This can be an annuity option offered by the employer (for an employer sponsored plan) or an annuity purchased for an IRA or an IRA rollover. Payment is assumed to be made monthly, starting on the distribution date, and ending either upon the death of the fund owner or after a fixed number of years, as specified on the detail screen.
- **Joint Life Annuity.** This option is similar to the Single Life Annuity, except that the term of the annuity is the combined lifetime of the fund owner and a beneficiary (usually, but not necessarily, a spouse).
- **10-Year Averaging.** Under this option, as with the Lump Sum option, it is assumed that all funds are withdrawn on the distribution date. However, under 10-year forward averaging, the fund owner takes advantage of a special tax treatment only available in employer-sponsored plans other than 403(b) plans, and only for participants born before 1936. If this option is not available for a given individual, it will be suppressed (appear in gray) and cannot be selected.
- **IRA Rollover.** Under this option, all funds are assumed to be rolled over from another plan into an IRA. If the plan is already an IRA, the funds are assumed to remain in the plan. If the plan is a 403(b) or a 457 plan, this option can also illustrate funds remaining in the plan. In all cases, no withdrawals are made except for Required Minimum Distributions, which are automatically calculated by the system once the fund owner attains age 70½. Loan amounts previously taxed are not eligible for rollover and are assumed to be withdrawn immediately, unless the original plan is a 403(b) or a 457 plan, in which case these previously taxed loan amounts are assumed to remain in the plan until Required Minimum Distributions kick in.
- **Partial IRA Rollover.** This option combines the first (Lump Sum) and fifth (IRA Rollover) options. A specified amount is assumed to be rolled over into (or retained in) an IRA. The balance is assumed to be withdrawn on the distribution date and taxed as ordinary income.
- **Rollover to IRA, Convert to Roth IRA.** This option involves rolling over the existing account to a traditional IRA, if it isn't already an IRA, then converting the



RetirementWorks®

IRA to a Roth IRA. The conversion is a taxable event, but after thereafter no income taxes are ever paid on the Roth funds. This option can pay off in the long run. Loan amounts previously taxable are NOT available for IRA rollovers, and Net Unrealized Appreciation on employer securities will be assumed to NOT be rolled over, since a rollover takes away the capital gains tax treatment of such gains. If taxes due at the conversion exceed these two amounts (the loan amount and the NUA amount), the amount converted is reduced to pay taxes. It might be more advantageous to pay taxes out of pocket, if cash is available to do so, and maximize the conversion amount.

When you check any one of the options, you will be taken immediately to the “Plan Distribution Options” detail screen.

The screenshot shows the RetirementWorks software interface. At the top, there is a menu bar with "File", "Print", "Calculations", "Windows", and "Help". Below the menu bar is a window titled "Lump Sum Distributions" with a close button (X). The window contains several input fields: "Name:" (text box), "Date of birth (mm/dd/yyyy):" (text box), "Tax year:" (dropdown menu set to "January to December"), and "Tax Filing Status:" (dropdown menu set to "Married Filing Jointly"). Below this is another window titled "Plan Distribution Options" with a close button (X). This window contains a list of options, each with a checkbox and associated fields:

- Lump Sum**
 - Is this participant subject to early withdrawal penalties? Yes No
 - Check here to use level payments to avoid penalty (72(t) rules)
 - Interest rate to be used in 72(t) calculations: %
- Single Life Annuity**
 - Term of the annuity: Life Yrs. Monthly payment \$
- Joint Life Annuity**
 - Date of birth of youngest beneficiary, other than the plan participant (mm/dd/yyyy):
 - Monthly payment \$
- 10-Year Averaging**
 - Amount attributable to deductible employee contributions \$
- IRA Rollover**
 - Date of birth of spouse, if beneficiary (mm/dd/yyyy):
 - Date of birth of oldest NON-spouse beneficiary, if any:
- Partial IRA Rollover**
 - Dollar amount of distribution to be rolled over into an IRA \$
 - If you participated in this plan prior to 1974:
 - How many months of participation did you have prior to 1974? (Count 12 mos. for each year if you participated even part of it)
 - How many months of plan participation did you have in 1974 or after? (Count only months when you participated for any portion of the month.)
- Rollover to IRA, Convert to Roth IRA**
 - Do early withdrawal penalties apply? Yes No

A "Close" button is located at the bottom right of the "Plan Distribution Options" window.



RetirementWorks®

This screen allows you to provide the additional information needed to produce a suitable estimate of fund balances and taxes.

Each option, if selected, requires at least one additional piece of information. Please review all fields that appear in blue; fields that appear in gray are suppressed and are not applicable either because you have not selected the corresponding distribution option or because of the age of the fund owner or some other reason.

You can select or de-select distribution options either on this detail screen or on the main screen.

Lump Sum

Is this participant subject to early withdrawal penalties?

Indicate whether or not the lump sum distribution is subject to early withdrawal penalties because the fund owner is under age 59½ (or, for many employer-sponsored plans, age 55). The system will default to "Yes" if the fund owner is under age 59½; otherwise it defaults to "No". There are, however, various reasons why a penalty may not apply, so you should evaluate this answer carefully. The 10% penalty never applies to Section 457 plans.

Check here to use level payments to avoid penalty (72(t) rules)

This field becomes active if you have answered "Yes" in the field above. If the early withdrawal penalty tax would apply, check this box if you would like the system to automatically calculate "substantially equal periodic payments" (so-called 72(t) distributions) in order to avoid the penalty. Under this arrangement, most of the funds will remain in the plan until after the fund owner turns 59½ or for five years, whichever occurs later. Then the remaining funds are assumed to be withdrawn at ordinary income tax rates.

Interest rate to be used in 72(t) calculations

This field becomes active if you have answered the previous two affirmatively. Indicate the interest rate you would like to use for the 72(t) calculations. You should be careful to use a "reasonable rate of interest". The system defaults to 8%, which is the value used in IRS Notice 89-25, which defines the 72(t) calculation methods.

Unfortunately, the IRS has not definitively specified what rates will be considered reasonable. In different Private Letter Rulings, they have approved use of 120% of the applicable federal mid-term rate, 120% of the applicable federal long-term rate, the present valuation rate used in Internal Revenue Code (IRC) section 7520, the average of the preceding 12 months' long-term rates used in IRC section 382, and the Pension



RetirementWorks®

Benefit Guaranty Corporation's rate used to value lump sum distributions. Stated rates as high as 10% have been approved at one time or another. However Private Letter Rulings apply only to the particular taxpayer who requested the ruling, and what is reasonable in one economic environment might not be considered reasonable when times change.

Single Life Annuity

Term of the annuity

Select "Life" or enter the number of years for payments to be made. The default is "Life". This is the normal form of an annuity and means that monthly payments will be made for as long as the annuitant lives. If a "Term" annuity is being used, however, this means the payments are made only for a specified number of years and you must specify the number of years in the space provided.

Monthly payment

Enter the amount the fund owner will receive each month. Please note that this is the monthly, not the annual, amount.

Joint Life Annuity

Date of birth of youngest beneficiary, other than the plan participant (mm/dd/yyyy)

Enter the date of birth of the spouse or other beneficiary under this option in mm/dd/yyyy format. If there is more than one beneficiary, use the date of birth of the youngest.

Monthly payment

Enter the amount the fund owner will receive each month. Please note that this is the monthly, not the annual, amount.

10-Year Averaging

Amount attributable to deductible employee contributions



RetirementWorks®

Distributions attributable to deductible employee contributions are not eligible for 10-year forward averaging, so that amount must be entered in this field. The law permitting such contributions was repealed in 1986. Any deductible employee contributions made before 1986 are supposed to be separately accounted for, so that the amount entered here should be readily available to you. Both the original contribution amounts and any earnings on them (net of withdrawals already taken) are to be included in this figure.

For fund owners born before 1936, the fields near the bottom of the screen, "If you participated in this plan prior to 1974 . . ." must also be entered.

IRA Rollover / Partial IRA Rollover

Date of birth of spouse, if beneficiary (mm/dd/yyyy)

This field is necessary for both the IRA Rollover and Partial IRA Rollover options. Enter the date of birth of a spouse beneficiary in mm/dd/yyyy format. If the spouse is not a beneficiary, do NOT use this field. This information is used to compute Required Minimum Distributions after age 70½.

Date of birth of oldest NON-spouse beneficiary, if any

This field is necessary for both the IRA Rollover and Partial IRA Rollover options. Enter the date of birth of the oldest non-spouse beneficiary in mm/dd/yyyy format. If there is more than one non-spouse beneficiary, use the date of birth of the oldest. If only the spouse is the beneficiary, do NOT use this field. This information is used to compute Required Minimum Distributions after age 70½.

Dollar amount of distribution to be rolled over into an IRA

This field applies to Partial IRA Rollovers only. If you are illustrating a partial rollover, enter the dollar amount to be rolled over into an IRA. The balance will be assumed to be distributed on the distribution date, taxable as ordinary income. Note that 10-year forward averaging is not available unless the ENTIRE plan balance is being distributed.

If you participated in this plan prior to 1974:

Two fields appear under this qualifier. They relate to service before and after 1974, and are available for input only for participants born before 1936 and only if all or part of the fund is being distributed on the distribution date as a lump sum, with or without forward averaging. These values determine the percentage of the fund attributable to pre-1974 contributions. This portion is eligible for taxation at capital gains rates (for participants



RetirementWorks®

born before 1936). The system will test whether capital gains treatment is advantageous; if it is, the system will use it for the eligible funds. Otherwise it will use ordinary income tax rates.

How many months of participation did you have prior to 1974?

Count 12 months of participation for every calendar year during which the fund owner participated at least part of the year. Even if there was only one month of participation in a given year, count 12 months for that year.

How many months of plan participation did you have in 1974 or after?

Count only months during which there was actual plan participation in 1974 or after. Count a month even if there was plan participation for only part of a month.

Rollover to IRA, Convert to Roth IRA

Do early withdrawal penalties apply?

This field allows you to indicate whether or not the lump sum distribution is subject to early withdrawal penalties because the fund owner is under age 59½ (or, for many employer-sponsored plans, age 55). The system will default to "Yes" if the fund owner is under age 59½, but only if he or she has a tax filing status of Married Filing Separately, or if taxable income is over \$80,000. This is because the 10% penalty generally does not apply to Roth conversions, except when Married Filing Separately filing status is used or when Adjusted Gross Income exceeds \$100,000. However, even when those conditions are not met, the penalty can be reinstated if the funds are withdrawn from the Roth IRA within the first five years.

The 10% penalty never applies to Section 457 plans.

When you have filled in or answered all the applicable items on this screen, click the "Close" button to return to the main screen.

Pre-tax rate of return on plan investments

Enter the rate of return, as a percentage, that the existing fund earns. This is used only for early retirement situations where the only distributions being made are the "substantially equal



periodic payments" under the Internal Revenue Code section 72(t). Funds remaining temporarily in the plan until the early retirement penalty period expires are assumed to increase at this rate.

Pre-tax rate of return on alternative investments

Enter, as a percentage, the rate of return that can be earned on a pre-tax basis outside of the original fund. This alternative investment may be a taxable side fund, or an IRA or IRA Rollover account in which funds are being kept as long as possible. It is assumed that essentially the same investments could be used in a taxable and a tax deferred fund, so the same pre-tax rate of return is assumed for both.

State + local tax rate on pension income

Enter, as a percentage, the combined state and local tax rate, if any, on pension income. Many jurisdictions have a lower tax rate for pension income than for ordinary income. But, where appropriate, this percentage can be the same as for the "State + local tax rate on ordinary income" below. If you do not wish state and local taxes to be taken into account, leave this field blank.

State + local tax rate on ordinary income

Enter, as a percentage, the combined state and local tax rate, if any, on ordinary income. If the jurisdiction in question has a different rate for investment income than for income earned from salary or wages, use the investment income rate. If you do not wish state and local taxes to be taken into account, leave this field blank.

State + local tax rate on capital gains

Enter, as a percentage, the combined state and local tax rate, if any, on investment capital gains. Again, many states have different rates for capital gains than for ordinary investment income. If you do not wish state and local taxes to be taken into account, leave this field blank.



RetirementWorks®

General inflation rate (applied to tax tables)

Enter the percentage by which the tax brackets from the most recently available federal tax tables should be assumed to increase annually. The current default is 2.5%. This field helps calculate taxes on future income. (The inflation rate will not be applied to future years where tax brackets have already been specified by law, however; the system knows the specified future rates and will use those instead.)

Annual rate of increase in taxable income (excluding distributions from this plan)

Enter the rate, as a percentage, at which the taxpayer's taxable income is assumed to grow in the future, other than income from the qualified plan distribution regardless of how that distribution is taken. For example, if one-third of the person's other taxable income will be received from Social Security, which is inflation-adjusted, and two-thirds from a corporate pension that is not inflation-adjusted, the overall rate of increase in taxable income may be quite low (e.g. 1% or less).

Next year's estimated taxable income, to be used as a base for future inflation (optional)

Enter the basic post-retirement amount of taxable income that the "Annual rate of increase in taxable income" above will apply to. This is asked because for many people, there are too many unusual transactions occurring in the year of retirement itself, and many of them result in taxable income. Using the year after retirement (the next year) as a base provides a more accurate rendering of what future income is likely to be. Again, do not include any income expected directly or indirectly from distributions from the qualified plan being calculated here. These taxable amounts will be handled automatically by the system. If you do not have an accurate estimate of the next year's taxable income, a ballpark figure will suffice (e.g. 50% of pre-retirement income). Leaving this value at zero will severely underestimate the future taxes associated with the qualified plan distribution. If there is not big difference between the year of retirement and the next year, you may leave this field blank, and the amount entered as "Estimated taxable income (EXCLUDING this distribution) for the current year" at the top of the screen will automatically be used as a base for future years.