AUSTIN POLICE RETIREMENT SYSTEM POST RETIREMENT OPTION PLAN (PROP)

HIGHLIGHTS OF INCOME TAX CONSEQUENCES OF DEFERRING ALL OR A PORTION OF YOUR MONTHLY ANNUITY INTO PROP

You may be eligible to defer (at your election) all or a portion of your monthly annuity into the Post Retirement Option Plan ("PROP"). If so, there are federal income tax consequences that you should consider before making an election to defer into PROP. The Austin Police Retirement System ("System") cannot provide financial or tax advice to you or tailor these highlights to your particular situation. However, these highlights will discuss some of the income tax consequences that result from deferral into PROP by retiring or retired members in various circumstances. You **should** consult a tax or financial advisor who has expertise in the federal income tax treatment of annuities and distributions from qualified pension plans before electing to defer your pension (or a portion thereof) into PROP. If you elect to defer less than your entire monthly annuity, the rules that the Board of Trustees has adopted provide that the portion that you defer cannot be less than $250.00 per month.

Annuity payments, under tax-qualified plans such as the System, are taxed when you receive them in much the same way as your salary was taxed before retirement. However, the part of the pension payments considered to be a return of the member's own after-tax contributions is eventually recoverable tax-free. Any annuity payments that you elect to defer into PROP will not be taxed until they are paid to you out of your PROP account. This can be attractive to you if you are working and in a higher tax bracket now, but expect to be in a lower tax bracket when you receive your PROP distribution. Unfortunately, the deferring of all or a portion of your pension into PROP can cause you to pay more federal income taxes in certain cases.

The Internal Revenue Service imposes an additional early distribution tax to certain payments received by a retired member before age 59½. The early distribution tax is 10% of the taxable payments received. This additional tax does not apply if you qualify for one or more exceptions to this tax. The most likely exceptions would be if (1) you terminate active service with the Police Department in or after the calendar year you attain age 50 (or age 55 if you are an employee of the System), or (2) you terminate active service before the year you attain that age 50, but receive only your monthly annuity payments until after you attain age 59½.

If you are eligible for the first exception to the 10% early distribution tax by terminating active service in or after the calendar year you attain age 50, then an election to defer all or a portion of your monthly annuity into PROP will not subject your monthly annuity to the early distribution tax. Furthermore, you will not owe the 10% early distribution tax when distributions are later made to you from your PROP account. On the other hand, if you terminate active service before the year you attain age 50, the eligibility for the second exception to the 10% early distribution tax may be adversely affected by an election to defer all or a portion of your monthly annuity into PROP or by a change in the amount that is deferred..

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If you leave active service before the calendar year in which you attain age 50 (age 55 if you are an employee of the System) and you receive payment of your monthly benefits for a period of less than five years before age 59½, you will owe the early distribution tax plus interest thereon, on the taxable monthly benefits you have received before age 59½. This will be the case if you initially defer receipt of your benefit (or a portion thereof) and later begin to receive payment or if you start receiving monthly benefits when you leave active service and later elect to defer all or a portion of your benefit, and the period you actually receive payment before age 59½ is fewer than five years.

If you leave active service before the calendar year in which you attain age 50 (age 55 if you are an employee of the System) and you receive payment of your monthly benefits for at least five years before age 59½, you will still owe the early distribution tax plus interest thereon if you defer receipt of your benefit and then revoke or modify your PROP deferral election before age 59½. The early distribution tax would be on the taxable monthly benefits that were deferred and on the taxable monthly benefits received after revoking the PROP deferral election but before age 59½.

Other exceptions are available sometimes that might enable you to avoid paying the early distribution tax. You will be responsible for identifying any exception that might be applicable to you and for paying the tax if you do not qualify for any exceptions.

Of course, the tax treatment of your monthly annuity is only one of the considerations you should take into account before electing to defer all or a portion of your monthly annuity into PROP. However, it is a very important economic consideration and you may want to time any election you make so as to minimize adverse tax treatment.

These highlights of possible income tax consequences of deferring all or a portion of your monthly annuity into PROP are not a complete description of all possible situations but are intended to make you aware in general that the 10% early distribution tax can be applicable and can be retroactive in its application.

I have read these highlights of tax consequences of deferring my monthly annuity into PROP.

Signature: ______________________________________ Date: _____________________

Printed Name: ____