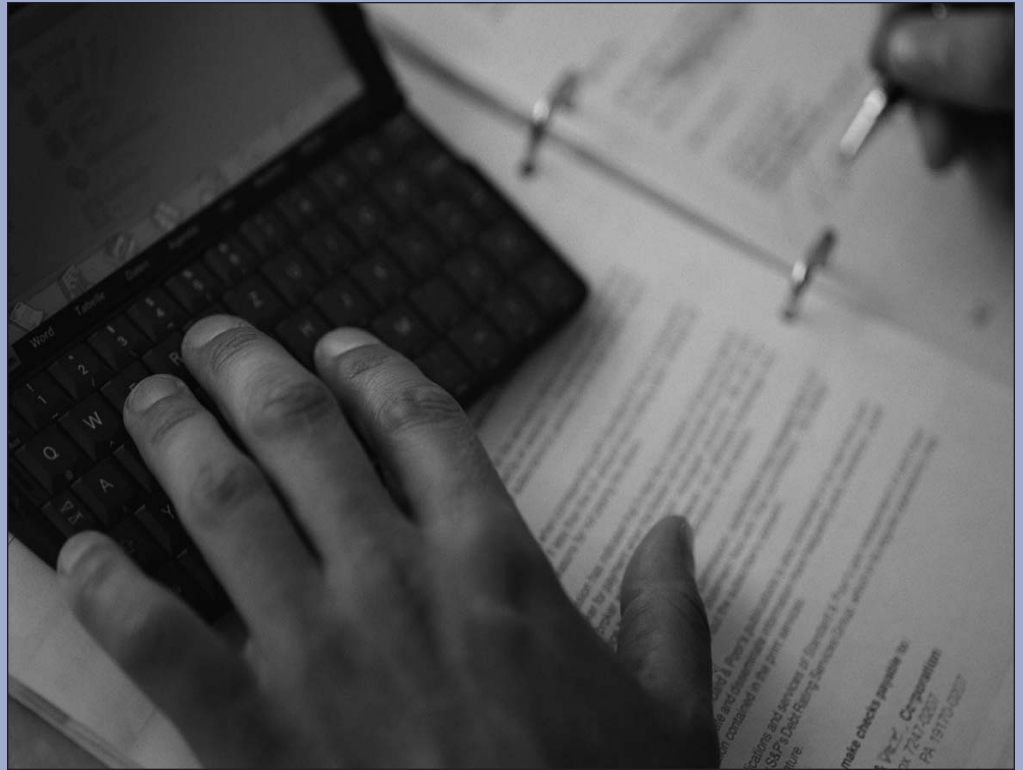


# Tax Liability on WRS Benefits

## Tax Liability on WRS Benefits





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This booklet provides general information about the income tax liability on your Wisconsin Retirement System (WRS) benefits. The tax treatment of WRS benefits is generally similar for federal and Wisconsin income tax purposes. There are a few exceptions such as retirement payments received by certain beneficiaries and teachers which are exempt for Wisconsin income tax purposes but not for federal purposes. See "Payments Exempt from Wisconsin Income Tax" section on page 7.

If you are not a resident of Wisconsin, you are not required to pay Wisconsin income tax. You should check with the tax department in the state where you reside for information on your state tax liability with them.

The **only** state we can withhold state taxes for is Wisconsin.

A WRS benefit is not wages, so is not subject to Social Security or Medicare taxes.

## Investment in Contract (IIC)

The amount of your WRS benefit which is non-taxable is based on your "Investment in Contract" (IIC). The Internal Revenue Service (IRS) refers to your IIC as your "cost in the plan." Your IIC is the portion of your retirement account that was actually paid by you from after-tax dollars, generally through payroll deductions. The rest of your

account consists of accrued interest and contributions paid by your employer(s). If you made regular additional contributions, your IIC is calculated separately for your additional account. If you made tax-deferred additional contributions before January 1, 2009, as an employee of an eligible educational employer, there is no IIC for those contributions. Tax-deferred contributions are always fully taxable when a benefit is paid. As of January 1, 2009, tax-deferred additional contributions cannot be made to any WRS account.

Your IIC for your required contributions is provided at the bottom of the "Employee Required Contributions" section on your annual *Statement of Benefits* (ET-7365).

## Monthly Annuities

The amount of your annuity in excess of your monthly IIC will be subject to tax in the year it is paid to you. The Department of Employee Trust Funds (ETF) will calculate your monthly IIC non-taxable amount using your total IIC and one of two IRS tables based on the option you select (your lifetime or your life and a joint survivor). For information about how annuities are taxed, refer to IRS Publication 575, or contact the IRS, the Wisconsin Department of Revenue, or your state's tax agency.

When you apply for your annuity, be sure to complete the income tax withholding information on the form provided. It is possible that your withholding election will result in no tax being withheld, depending on the taxable amount of your benefit and the withholding election that you make. If you do not specify how you want taxes withheld, federal regulations require ETF to withhold according to the tax tables assuming you are married with three exemptions.

Wisconsin law does not require that state income tax be withheld from your monthly annuity. However, you may request that Wisconsin income tax be withheld.

Please carefully review the following details about income tax withholding.

Federal tax withholding must be based on the IRS tax tables, so you *cannot* request only a specific dollar amount. However, you may elect federal tax withholding according to the tax tables *plus* an additional amount. Unless you elect not to have federal taxes withheld, the withholding amount will automatically be updated when the tax tables change or your gross payment changes.

If you elect Wisconsin tax withholding according to the tax tables, your Wisconsin tax withholding amount will automatically be updated when the tax tables change or your gross amount changes. The Wisconsin Department of Revenue requires that if you elect state tax withholding, the minimum withholding amount is \$5.00.

Income tax withholding from retroactive increases or back pay such as the final calculation or first payment to a disability annuitant or an alternate payee may be much higher than your election for your monthly benefit. An alternate payee is a WRS employee's former spouse who is awarded a percentage of his or her WRS account and/or annuity by a Qualified Domestic Relations Order (QDRO). Federal tax laws require 25% withholding on retroactive increases and back payments; Wisconsin laws require about 4.6% to 6.75%. This applies to the portion of your payment that is for a period *before* the latest month paid. It will either increase your tax refund or decrease your tax payment when you file your annual tax return. Please consider this when making your election or you may want to change your withholding for the remainder of the same tax year.

You can view the federal and Wisconsin tax withholding tables on our Internet site at <http://etf.wi.gov/retirees.htm> to help you decide how to request your monthly tax withholding.

If you do not have Wisconsin income tax withheld and you are a resident of Wisconsin, you may be required to make estimated tax payments. Generally, if you would have

to pay \$200 or more with your Wisconsin income tax return, you must prepay your tax each year by making estimated tax payments. Estimated tax payments are made by filing an *Estimated Tax Voucher*, Form 1-ES. Failure to make required estimated tax payments might result in interest being assessed on the underpaid amount. You can obtain further information and Form 1-ES from any Department of Revenue office.

If you receive payments from an annuity certain of less than ten years from your additional contributions, federal law requires your total tax withholding to equal at least 20% of the taxable portion of your annuity certain payments, unless you directly roll over the taxable portion of your payments into an eligible employer plan or an Individual Retirement Account/Annuity (IRA). However, if you begin an annuity certain of less than ten years in the year in which you reach age 70½ or later, a portion of your benefit is a required minimum distribution under federal law. Federal withholding is voluntary on the required minimum distribution amount; the mandatory 20% withholding applies only to the portion of your benefit in excess of that amount. The required minimum distribution amount cannot be rolled over. If you made additional contributions and take an annuity certain prior to age 59½, you may be assessed the 10% federal and applicable state early distribution tax on the taxable portion of those monthly payments paid to you before you reach age 59½.

You can change your withholding election at any time by requesting and completing an *Income Tax Withholding Election* form (ET-4310) or by calling our toll-free self-service line at 1-877-383-1888 or (608) 266-2323 (local Madison). Allow at least six weeks after we receive your election for the change to be reflected in your monthly payments.

In January of each year, an annuitant 1099-R tax form for the prior year is mailed to your home address. To ensure that you receive it, you must notify us promptly of any changes in your home address. The 1099-R includes details for the past year such as the gross and taxable amounts of your annuity, the amounts of federal and state tax withheld, insurance premiums deducted, and also your original IIC. You might be required to file a copy of your 1099-R with your income tax returns for the prior year, so keep this with your important tax records.

You will receive a separate annual 1099-R tax form for each of your WRS annuity accounts if you receive multiple WRS annuities. An example is you receive an annuity from your own WRS account and as a beneficiary of another account. The 1099-R forms will be mailed in separate envelopes and may arrive on separate days. It is important that you account for all of your 1099-R forms when you complete your annual income tax returns.

If you receive a disability annuity, contact your tax consultant or your nearest IRS office for information about possible special tax treatment of your disability annuity.

## Minimum Distribution Requirements

If you have an inactive account with the WRS, federal law and Wisconsin statutes require you to receive a minimum distribution amount each year beginning with the year in which you reach age 70½.

If you do not apply for your WRS benefit on a timely basis, we are required by law to begin



an automatic distribution of your WRS account to you. This may be a lump sum payment that would close your account and result in a tax liability or an effective date that you would not want.

Wisconsin statutes limit the optional forms of payment in which you can receive your WRS contributions; this could affect when your benefit must begin to meet the minimum distribution requirement. If your covered WRS employment will end in your 70½ year or later, you should request WRS annuity estimates up to one year in advance and begin your benefit during that year. Contact the IRS or your tax advisor for information about meeting the federal minimum distribution requirement.

## Lump Sum Benefits

The amount of your benefit in excess of your IIC is fully taxable when paid. Under federal law, if you do not directly roll over the taxable portion of your lump sum payment into an eligible employer plan or an IRA, ETF must withhold 20% of the taxable portion of your payment as federal income tax. State income taxes will not be withheld from any lump sum payment, so you may want to keep part of your payment to cover your state income tax liability (if any).

IIC contributions may also be rolled over (except not to Sec. 457 governmental deferred compensation plans) if the receiving plan is prepared to account for these contributions separately.

**EARLY DISTRIBUTION TAX:** In addition to federal and state income taxes, there is also an additional 10% federal tax on the taxable portion of any lump sum payment made to you before you reach age 59½. In some instances, this may not apply if you terminated covered employment in the year you reached age 55 or later. Contact your tax consultant or the IRS for details about other exemptions from this tax, such as for death benefits, payments made to an alternate payee pursuant to a QDRO, or withdrawals due to total and permanent disability. When there is a federal additional tax, you may also owe a state tax, depending on the state you are a resident of. In Wisconsin, the additional tax is 33% of the federal 10%, so it is

3.33% of the taxable gross benefit. No additional tax will be deducted from your payment.

A 1099-R form which shows the amount of income tax withheld (if any) and the taxable and non-taxable portions of your benefit will be enclosed with your check.

**Keep your copy of the 1099-R;** you will need it when you file your income tax forms for the year in which the check is issued.

For information such as IIC, time limits, restrictions, etc., which could affect your rollover eligibility or details about the early distribution tax reporting, capital gains treatment or the 10-year tax option, contact your tax advisor, your state's tax agency and/or your nearest IRS office.

## Rollovers

You are generally eligible to roll over WRS payments paid as lump sum distributions or as an annuity certain paid for a period of less than ten years (additional contributions only). See the Exception box below. Federal law requires ETF to withhold 20% of the taxable portion of lump sum payments and monthly payments from annuities certain of less than ten years, unless you directly roll over these payments into an eligible employer plan or an IRA.

**EXCEPTION:** Lump sum benefits of less than \$200 cannot be rolled over and the 20% mandatory withholding does not apply. Also, if you take a lump sum benefit or begin an annuity certain of less than ten years (from additional contributions only) in the year in which you reach age 70½ or later, a portion of your benefit is a required minimum distribution under federal law. Federal tax withholding is voluntary on the required minimum distribution amount; the mandatory 20% withholding applies only to the portion of your benefit in excess of that amount. The required minimum distribution amount cannot be rolled over.

Required and regular additional and tax-deferred additional contributions can be rolled over into IRAs, Sec. 403(b) tax sheltered annuity plans, Sec. 457(b) governmental deferred compensation plans, or another eligible employer plan. You can request that part or all of your payment(s) be directly rolled over; however, ETF must withhold the 20% from any taxable portion that is not directly rolled over. With a direct rollover, the WRS issues a check payable directly to the other plan or IRA. To request a direct rollover, you must submit an *Authorization for Direct Rollover* form (ET-7355) to ETF with your application for benefits. This form is available from the Department of Employee Trust Funds. If you request a direct rollover, the check for any portion not being directly rolled over will be issued payable directly to you.

If you do not request a direct rollover with your application, any payment will be issued payable to you. Your payment will be taxable in the year in which it is issued unless you decide within 60 days to roll it over into an eligible employer plan or IRA. If the taxable amount exceeds the net amount you receive after the required 20% is withheld and you wish to roll over the full taxable amount, you must obtain the remainder from other sources. We cannot refund the 20% federal withholding to you. You will be able to report the 20% on your income tax return. You can avoid this shortage of funds to roll over the full taxable amount if you send the ET-7355 rollover form so the Department of Employee Trust Funds (ETF) receives it before your check is issued.

Whether a payment is issued directly to you or you elect a direct rollover, all payments will be mailed to your address. If you are rolling over your payment, you are responsible for delivering the rollover check to the receiving financial institution.

Alternate payees have the same rights as WRS employees to roll over their benefit.

## Death Benefits

If you are applying for a death benefit from the account of a deceased participant and some benefits have already been paid from that account, credit for part or all of the IIC will already have been used. The non-taxable portion of the death benefit, if any, will be based on several factors: the original IIC; the benefits already paid from the account; and, if the deceased participant was an annuitant, the begin date of the original annuity and the option selected.

Monthly death benefits are taxable except for the IIC. For a death benefit paid to a named joint survivor, the monthly IIC continues to be reported as the non-taxable amount the same as it was for the WRS employee. For other monthly death benefits, the entire gross annuity will be reported as non-taxable payments until the IIC balance is zero. Once the IIC balance is zero, then the entire gross annuity is reported as taxable.

Your death benefit application will tell you if you are eligible to choose a monthly or lump sum benefit, or if you are restricted to one method. If you are a surviving spouse and do not directly roll over your lump sum death benefit, the mandatory 20% withholding will apply. If you are not a surviving spouse, this withholding does not apply to you, but you may want to request withholding or keep part of your lump sum payment to cover your federal tax liability. No state income taxes are withheld from a lump sum death benefit, so you may want to keep part of your check to pay any state income tax you will owe, (if taxable by your state of residence).

If your death benefit is paid monthly, you will receive a 1099-R tax form in January each year. If your death benefit is paid as a lump sum payment, the 1099-R will be sent with the check. Keep the 1099-R with your important tax records for filing your income tax returns for the year of payment(s).

As a surviving spouse beneficiary, you have the same rights to roll over an annuity certain of less than ten years (additional contributions only) or a lump sum benefit that the WRS employee could

have rolled over, see “Rollovers” section. You are eligible to roll over WRS death benefits from an annuity certain of less than ten years or a lump sum payment into a non-WRS retirement account, such as an IRA, Sec. 403(b) tax-sheltered annuity, Sec. 457(b) governmental deferred compensation plan or other eligible employer plan. If you have an existing WRS account, you cannot roll over the WRS death benefit into your own WRS account. Minimum distribution requirements may apply.



Effective January 1, 2007, the federal Pension Protection Act of 2006 allows certain non-spouse beneficiaries, including qualifying trusts, to **directly** roll over death benefits from qualified plans to an **Inherited** IRA. You have the option to choose a **direct** rollover of the death benefit if you are a beneficiary either named by the WRS employee (or alternative payee if applicable) on the latest valid beneficiary designation received by ETF or by WRS statutory standard sequence as of the employee's or alternate payee's death. The *Authorization for Direct Rollover* form (ET-7355) will be included with your death application if ETF records indicate you have this option. Unlike a WRS employee, alternate payee, or a surviving spouse who has 60 days from when the lump sum check is received to decide to roll over the funds, a non-spouse designated beneficiary's direct rollover ET-7355 form must be received by ETF before the lump sum check is issued. Another difference is that you can **only** roll over the funds to an **Inherited** IRA that is established to receive the funds and is specifically titled with the decedent's name.

Depending upon the age of the WRS employee or alternate payee at death and when the non-spouse designated beneficiary receives the death benefit, a required minimum distribution might apply.

A lump sum death benefit payable to the estate, a non-qualifying trust, or a beneficiary not designated by the WRS employee or alternate payee, or by statutory standard sequence on the employee's or alternate payee's death cannot be rolled over. As one of these types of beneficiary, you are only eligible to receive the payment since you are not eligible to roll over any portion of the death benefit.

The Department of Employee Trust Funds (ETF) sends Federal and Wisconsin distribution requirements to a beneficiary with a death benefit application. This is on the *Information for Beneficiaries of WRS Accounts* form (ET-6102).

Wisconsin does not impose an inheritance tax. For information on Wisconsin or Federal estate tax or details about the 10-year tax option, capital gains treatment on lump sum death benefits, rollovers, etc., contact your tax advisor or the Wisconsin Department of Revenue and your nearest IRS office.

## Payments Exempt From Wisconsin Income Tax

Some payments received from the WRS are exempt for Wisconsin tax purposes (they are not exempt for federal tax purposes):

1. Payments received by a beneficiary of a deceased employee who died on or before December 31, 1967.
2. Payments received from the WRS if the payments were paid on the account of a person who was a member of the State Teachers Retirement System or the Milwaukee Teachers Retirement Fund as of December 31, 1963, or was retired from one of those retirement systems as of that date. This exemption also applies to a beneficiary of a person who was a member of one of those systems as of December 31, 1963,

or was retired as of that date, and to an alternate payee under a QDRO if the former spouse qualified for the exemption.

### CAUTION:

- Only payments from accounts established before 1964 qualify for the exemption. For example, you were a member of the State Teachers Retirement System as of December 31, 1963, you left teaching after 1963 and withdrew the allowable contributions from your retirement account, completely closing the account. This withdrawal qualifies for the exemption. If you later return to teaching, a new account would be established for you in the retirement system. Any retirement benefits from the new account established after 1963 would not qualify for the exemption.
- WRS participants may make voluntary contributions to their retirement accounts in the form of "regular additional contributions" or prior to January 1, 2009, "tax-deferred (tax-sheltered) additional contributions." If you qualify for the exemptions described in #2, a benefit you receive from "regular additional contributions" is also exempt from Wisconsin income tax. However, a benefit you receive from "tax-deferred additional contributions" is subject to Wisconsin income tax.
- If WRS payments are based on participation in two or more different retirement funds (for example, participation in the State Teachers Retirement System and in the Wisconsin Retirement Fund), the entire payment may not be exempt. See the instructions for your Wisconsin income tax form for further information.
- 3. For tax years beginning on or after January 1, 2009, individuals who meet the age and income requirements may be eligible to subtract up to \$5,000 in qualified retirement plan income from Wisconsin taxable income. Contact your tax advisor or the Wisconsin Department of Revenue for details.

Call IRS at 1-800-829-1040 for questions on Federal Taxes

## Wisconsin Department of Revenue Offices

Contact any of the Wisconsin Department of Revenue offices listed below for questions on Wisconsin taxes.

### **Appleton**

265 W. Northland Ave.  
(920) 832-2727

### **Madison**

2135 Rimrock Road  
(608) 266-2772

### **Eau Claire**

State Office Bldg. – 718 W. Clairemont Ave.  
(715) 836-2811

### **Milwaukee**

State Office Bldg. – 819 N. 6th St.  
(414) 227-4000

The information in this brochure on Wisconsin tax liability reflects the interpretations by the Wisconsin Department of Revenue. New laws, new administrative rules, and court decisions may change the Wisconsin Department of Revenue's interpretations.

When corresponding with ETF, be sure to include the following information which will help us identify your account:

- Your name
- Your Social Security number
- Your date of birth
- For deaths, the WRS employee's or alternate payee's name **and** Social Security number or member ID number (if deceased was an annuitant.)

*The Department of Employee Trust Funds does not discriminate on the basis of disability in the provision of programs, services or employment. If you are speech, hearing or visually impaired and need assistance, call toll free at 1-877-533-5020 or (608) 266-3285 (local Madison). We will try to find another way to get the information to you in a usable form.*

The Department of Employee Trust Funds (ETF) has made every effort to ensure that this brochure is current and accurate. However, changes in the law or processes since the last revision to this brochure may mean that some details are not current. Please contact ETF if you have any questions about a particular topic in this brochure.

# For Additional Information

## Contact the Department of Employee Trust Funds (ETF)

### Self-Service Toll Free Telephone Services

Available 24 hours a day, seven days a week. You must have a touch-tone telephone to use these systems.

**SELF-SERVICE LINE:** Call 1-877-383-1888 or (608) 266-2323 (local Madison) to request forms or brochures. Wisconsin Retirement System annuitants may also change their home mailing address or tax withholding election through this self-service line.

**TELEPHONE MESSAGE CENTER:** Call 1-800-991-5540 or (608) 264-6633 (local Madison) to hear detailed recorded messages covering a variety of Wisconsin Retirement System topics.

**Note:** *You will not be able to talk to a "live" person using these systems. To speak to a benefits specialist, call the telephone numbers listed below.*

### Visit our Internet Site

Access the internet site at: [etf.wi.gov](http://etf.wi.gov). A tremendous amount of information is on-line regarding the Wisconsin Retirement System and other benefit programs. You may e-mail ETF through this site.

### Call During Office Hours

**Office Hours:** 7:45 am to 4:30 pm, Monday through Friday  
(except holidays)

**Telephone:** 1-877-533-5020 (toll free)  
(608) 266-3285 (local Madison)

Wisconsin Relay Service (for hearing & speech impaired)  
7-1-1 or  
1-800-947-3529 (English)  
1-800-833-7813 (Spanish)

### Write Us

Department of Employee Trust Funds  
P. O. Box 7931  
Madison, WI 53707-7931

### Visit Us

**Appointments:** 1-877-533-5020 ext. 65717 (toll free)  
(608) 266-5717 (local Madison)

**Madison:** **An appointment is recommended**  
801 West Badger Road

**Waukesha:** **An appointment is required**  
141 N.W. Barstow Street, Rm.411

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