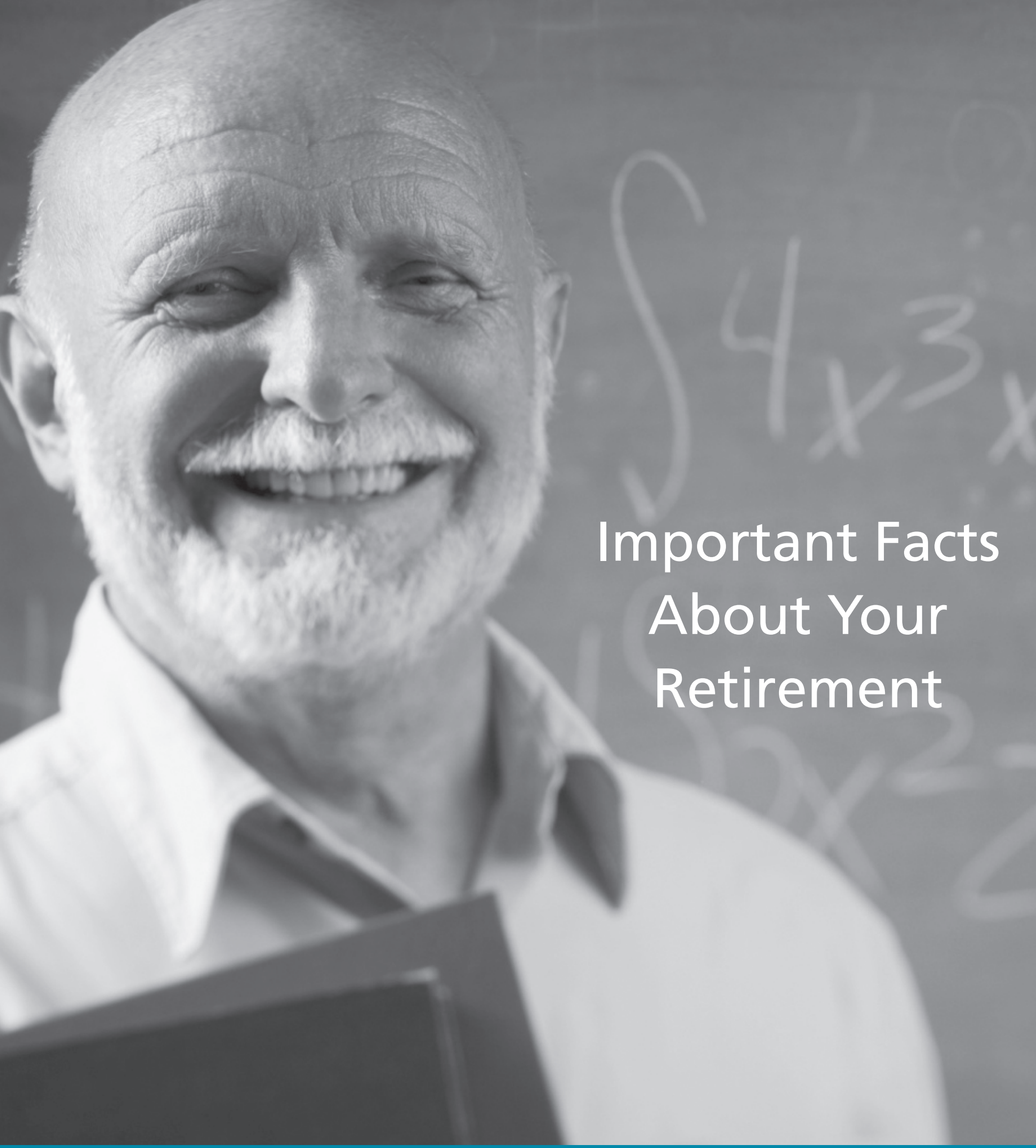

Important Facts About Your Retirement

A Legacy of Success. TDS Tax Deferred Solutions A Lifetime of Service.

CSBA
California School Boards Association
Partner Since 1995

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Tax Deferred Solutions (TDS)
TDS is a California based, full service plan administrator providing services to schools and municipalities since 1978. An innovator in the industry, TDS is the largest California based TPA providing Common Remitting services, full 403(b)/457(b) compliance and management, proprietary 457(b) plan and implementation. We proudly provide services for employers of all sizes – serving some of the largest districts and county offices in the state as well as districts of moderate size. TDS is a proponent of choice for 403(b) and 457(b) investment offerings for plan participants.

California School Boards Association (CSBA)
The California School Boards Association is a collaborative group of virtually all of the state's more than 1,000 school districts and county offices of education. It brings together school governing boards and their districts and county offices on behalf of California's children. CSBA is a member-driven association that supports the governance team — school board members, superintendents and senior administrative staff — in its complex leadership role.

TDS has been a California School Boards Association Business Service partner since 1995. CSBA proudly works with the TDS to provide time saving, cost effective tax deferred compensation management solutions. These solutions are easy, efficient and compliant.

Retirement and Your 403(b)/457 Plans
Many participants in the state retirement plans, (PERS and STRS), also contributed to a voluntary supplemental retirement plan. The two plans available to public school employees directly through the employer are 403(b) and 457(b) plans. The most common plan is the 403(b) plan which has been available to employees of public schools for over 30 years.

For much of those 30 years, the plans were not heavily regulated by the IRS. While they did establish rules and procedures, the IRS did not have a formal method of tracking contributions, transfers, loans, or other transactions. This resulted in some mistakes and errors, such as excess contributions and loans. Additionally, the IRS had no system in place for "tracking" the assets as they do for other retirement plans. This made it virtually impossible for the IRS to ensure ongoing compliance with the plans. This all changed with the introduction of new 403(b) regulations introduced by the IRS in 2007 and implemented in January of 2009. This report is a highlight of the new regulations that affect you as a retiree, or as an employee who has separated from service with an eligible employer.

New IRS Regulations
On July 23, 2007 the IRS issued new 403(b) regulations with an effective date of January 1, 2009. The new regulations are designed to increase tax compliance on these plans as well as ease the oversight duties of the IRS.

The new changes were broad, but most significantly require much greater oversight by the employer. For example, before the implementation of the new regulations, employees could transfer funds to whichever investment provider they chose. Additionally they could secure a loan by self-certifying their eligibility. In both of these examples, the employer was not involved in the process or informed in any way. Now, not only is the employer required to be involved, they must approve the transactions. For this reason, many employers contracted an outside firm, known as a Plan Administrator, to handle all compliance activity related to 403(b) plans.

Role of the Plan Administrator
The plan administrator (PA) is contracted by the district to monitor all of the activity within the plan, and maintain compliance. The PA performs a very important function for the employer and all employees; if the plan is found to be out of compliance by the IRS, the entire plan could be disqualified. The result of plan disqualification would be immediate taxation on all the assets in the plan. While this would be extreme, it is unfortunately possible. More likely though, the employer would be fined and pay penalties for any found violations.

Among other responsibilities, the plan administrator must manage the following activity on your 403(b) accounts, even if you are retired or separated from service:

- Approve transfers from one provider to another
- Approve loans
- Monitor and approve distributions

Transfer Approval
The new regulations require vendors/investment providers to share information with the IRS on an annual basis. Some vendors opted not to comply with the new regulations, and therefore are not eligible to receive 403(b) plan assets. All approved vendors are listed by district on the California required website, www.403bcompare.com .

When a participant requests a transfer, the plan administrator must ensure that the desired new investment is an approved provider. If they are not on the approved list, the plan administrator has no choice but to disallow the transaction. If they allowed the transfer to occur, the entire district plan could be found out of compliance and disqualified. .

Even in retirement, the employer must control where the money is invested to remain compliant as long as it remains in the 403(b) plan. As a retiree or separated employee, if you choose to transfer your retirement assets to a new plan, they must first be approved by the district - even if you left employment many years before!

Loan Approval
Prior to the new regulations, participants in 403(b) plans could secure a loan against their account by working directly with the vendor in a 'self-certification' process. Today, this process has changed significantly. A participant can still secure a loan, but it must be approved by the PA before it will be processed by the vendor. This does extend the time it takes to receive a loan, and participants should consider this when applying.

As with transfers, the new loan procedures affect retirees or people that are no longer employed by the district. As long as your retirement assets remain in that employer's 403(b) plan, they will be subject to the rules laid out in the plan document.

Gaining control of your retirement assets
As discussed previously, the assets in your 403(b) (and 457(b)) accounts remain under the control of your employer's retirement plan. While these retirement plans were better during employment, they become more cumbersome once separated from service.

One option that many participants consider to gain control of their money is to convert the accounts to an Individual Retirement Account (IRA). By converting to an IRA, the participant has complete control over the assets and no longer needs employer approval for any transaction.

Control and more choice
By converting an employer sponsored retirement plan to an IRA, a participant is subject only to the broader rules regulating IRAs. First, a participant converting the funds to an IRA will no longer need employer approval for any transaction. Second, there is nearly an unlimited choice for investment options with an IRA, unlike 403(b) or 457(b) plans.

Strategies to defer taxes for heirs
In addition to giving the participant more choice and control, an IRA does the same for beneficiaries. As Americans have watched their retirement accounts grow over the years, many have not been informed

and are not aware of the huge impact that income and estate taxes can have upon the amount their heirs will actually receive after their death due to not implementing proper estate planning. The combined effect of that tax liability, in some circumstances, can consume more than two-thirds of the retirement account! Given the fact that Americans have over $7 trillion dollars in IRA and similar retirement accounts, which is a huge financial windfall that could potentially go to Uncle Sam and not to the heirs as intended.

Beneficiary Designation

While multiple beneficiaries allow you to "share the wealth" among your loved ones, the manner in which those assets may be distributed upon your death may not be what you had in mind when making those designations. For example, if an IRA owner chooses a young beneficiary and a much older beneficiary, such as a parent or sibling, for the same IRA account, the lost tax deferral for the younger beneficiary can be a significant one.

IRA accounts ideally are structured so that beneficiaries can take distributions based on their personal situation and/or based on their individual ages. For example, an IRA owner has three designated beneficiaries. One is their mother, age 65. The others are their children, ages 16 and 20. Depending on how the accounts are structured, the children could be forced to take distributions based upon the distribution schedule of the 65 year old, eliminating years of tax deferral they would otherwise have enjoyed. That tax advantage and its potential to greatly increase the value of the inheritance is a gift you don't want to give away—especially to the government. Leaving funds to a non-individual such as an estate or trust generally requires taxes to be paid on the entire IRA balance within 5 years. Here again the IRS allowed deferral for "Living Beneficiary" is lost, consuming a large portion of the IRA in taxes.

How to Avoid This?

There are a number of strategies that the IRA owner can employ to address this problem. Some of these strategies can be used by the heirs after the IRA owner is deceased. There are other strategies that the IRA owner can implement before death to avoid putting that burden on their heirs.

Pre-Death Options

The creation of a master trust with separate sub-trusts for each beneficiary is one option to consider. In 2005 the IRS issued a favorable ruling on the subject based on the opinion that sub-trusts, and not the master trust in question, were the named beneficiaries of the owner's

IRA. Note that this is a specific type of trust set up solely for the IRA distribution purpose. A standard revocable living trust will not work for this strategy.

Another option is to create separate IRAs before death naming a separate beneficiary for each IRA. However, if the accounts grow at different rates, the objective of leaving a certain portion of the owner's estate to each beneficiary may not be accomplished. Further, some family members may feel "cheated" if their IRA did not perform as well.

Post-Death Options
The individual beneficiaries who are not taking their shares of the inherited IRA through a trust may ask that the IRA be divided into separate accounts after the death of the owner. If done by December 31 of the year after they year of the IRA owner's death, they are then able to use their own life expectancy to calculate minimum distributions. Another advantage to this strategy is that it allows each beneficiary to direct the investment strategy of their own portion of the inheritance.

Another option available is the use of a qualified disclaimer. A beneficiary can "disclaim" their inheritance, leaving it to the second beneficiary. The beneficiary may execute a disclaimer of their interest in the IRA within 9 months of the death of the owner. This works well if there is a great discrepancy in ages between the sharing beneficiaries. The remaining beneficiaries then could receive payouts based on a longer life expectancy. An important note on this strategy: a disclaiming beneficiary can not name a "replacement" beneficiary if they pass on the inheritance. Therefore, unless the original IRA owner names multiple beneficiaries or a contingent beneficiary, this strategy may not work.

In a move similar to a disclaimer, the executor of the estate can elect to pay the older beneficiary the portion of the IRA funds to which they are entitled prior to September 30 of the year after the death, removing them as beneficiary. The remainder beneficiaries will then enjoy a longer tax deferral and a larger inheritance over time.

Facts about taxes and your retirement
Most people have worked hard for a long time, saving and preparing in order to ensure for themselves a comfortable retirement. Besides their own futures, they also strive to leave a financial legacy to their loved ones through carefully planning their retirement finances. What is often not recognized is that every choice made in these plans can affect the owner's tax liability while they are living and the tax liability of their beneficiaries after their death.

Strategies to Defer/Avoid Taxes During Retirement
There are a number of effective strategies that help the retiree enjoy more of their retirement dollars and give less of those dollars to the IRS during their golden years.

One approach to consider is to put off taking social security benefits to avoid being thrown into a higher tax bracket when social security income is combined with the minimum required distribution of the IRA.

On speculation that taxes will rise, some individuals opt to take early withdrawals from their IRA (though beware, before age 59 ½ a federal tax penalty of 10%, will be applied to the withdrawal). While income taxes will be required on the disbursement at the time it is taken, transferring those funds to a Roth IRA (if eligible) could protect against future tax liability as assets in the Roth account compound tax-free and withdrawals are tax-free, as well.

Owners of employee stock in a qualified plan could consider taking a distribution now under the “Net Unrealized Appreciation” or NUA rule. While they will pay income tax, it will be calculated on the basis of the stock’s value at the time of distribution allowing the deferral of tax payments on capital gains until the stock is sold (early withdrawal penalties may apply).

Conclusion
As Americans move in larger and larger numbers toward retirement, it is essential to take the necessary steps to insure the security of their retirement, maintain control of their accounts, and ensure the legacy they intend to leave to their heirs remains intact. TDS has many free, on-line resources easily accessible to assist participants in planning for their future. Visit our website at www.tdsgroup.org for more information.

Contact TDS for more information.

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