All lump sum payments from SERS are exempt from Illinois income tax, but are subject to federal income tax. The amount of the lump sum payment subject to income tax includes a member’s contributions made after December 31, 1981, and interest credited on all contributions (see the Rollovers section). A form 1099-R will be issued in January following the year in which the payment is made.

Rollovers
The Internal Revenue Code permits you to defer federal income taxation and avoid withholding on a lump sum payment by “rolling-over” the payment.

The lump sum payment may be rolled over to another qualified employer plan that accepts rollovers, or to a traditional IRA or Roth IRA. The non-taxable portion may be rolled over if you ask SERS to do a direct transfer. If the non-taxable portion of the lump sum is rolled over to another qualified plan or 403(b) plan, the plan must also agree to separately account for the non-taxable portion of the rollover. If you ask SERS to do a direct transfer rollover to a qualified employer plan, traditional IRA or 403(b), you may defer taxation on the taxable portion and avoid federal income tax withholding (special IRS rules apply). If you roll over to a Roth IRA, you will be taxed on the amount rolled over.

If you do not ask SERS to transfer the payment directly to another qualified employer plan, traditional IRA or 403(b), 20% of the taxable portion will be withheld as federal income tax and the balance will be mailed to you (see the Federal Income Tax Withholding section). You may also be eligible to use the capital gains treatment, or the ten-year averaging method to determine your taxes.

If you do not ask SERS to do a direct transfer, you can still do a rollover of the payment to another qualified employer plan or IRA within 60 days of receiving the payment. You are permitted to rollover the entire payment, including the 20% that was withheld, but you will have to use other money to contribute to the IRA to replace the 20% withheld. You can also rollover the 80% you received, and be taxed on the 20% withheld from your payment. You or your spouse may not rollover the non-taxable portion of a lump sum payment to a 457 plan (Deferred Compensation).

Since qualified plans are not legally required to accept a rollover, before deciding to roll over your lump sum payment to a qualified plan, you should find out whether that plan accepts rollovers. If you apply for a lump sum payment that is eligible for rollover, additional information regarding the IRS rollover rules is provided with your payment application.

Capital Gains & Ten-Year Averaging
The ten-year averaging method and the capital gains provisions for lump sum payments has been repealed. However, a transition rule applies to you, your spouse, trust, or estate if you were age 50 before January 1, 1986. This rule allows ten-year averaging at 1986 tax rates, and capital gains treatment at a 20% tax rate. The averaging method may not be chosen unless you participated in SERS for at least five years. The five-year participation rule does not apply to death benefit distributions. If you were not age 50 before January 1, 1986, the capital gains treatment may not be used.

10% Excise Tax on Distributions Before Age 55
A refund of contributions after termination of employment before age 55, is subject to a 10% excise tax. This tax does not apply to a refund of contributions following termination of employment after age 55, or to death or disability. Effective August 17, 2006, this tax does not apply to distributions to employees who provide police protection, firefighter services, or emergency medical services following termination after age 50. The portion of the refund of contributions subject to the 10% excise tax is the refund paid in excess of the employee’s contributions that are not rolled-over (see the Rollovers section).

FEDERAL & ILLINOIS ESTATE TAX

Estate Tax
SERS death benefits may be subject to federal and Illinois estate tax. Refer to IRS Form 706 for further instructions regarding federal estate tax. Refer to Form 700 and the “Estate Tax Instruction Sheet” found at the Illinois Attorney General’s website (illinoisattorneygeneral.gov) for further guidance regarding Illinois estate tax.
In this brochure, for tax purposes, the term “employee contributions” generally refers to:

• Contributions made to SERS prior to January 1, 1982. These contributions were made on an after-tax basis.

• Contributions and interest paid on an after-tax basis for optional service purchases.

FEDERAL & STATE INCOME TAX WITHHOLDING

State Income Tax Withholding
All benefits paid by SERS are exempt from Illinois income tax withholding.

Federal Income Tax Withholding

Monthly Payments
Other than monthly occupational disability benefits and occupational death benefits, all monthly payments made by SERS are subject to federal income tax withholding in accordance with Federal Withholding Tables. When you apply for a benefit, you will be asked to complete a W-4P for income tax withholding.

You may elect not to have withholding taken, or to have withholding taken at any level. If you do not indicate a preference for withholding, federal taxes are withheld at the rate for a married person with three exemptions. You may change your withholding or discontinue withholding at any time.

Lump Sum Payments
All lump sum payments are subject to federal income tax withholding. Withholding may be avoided in certain cases by rolling-over the payment (see the Rollovers section).

If you or your spouse are receiving a payment that is eligible for direct transfer to another qualified employer plan [401(a), 403(b) or 457] or a traditional IRA or Roth IRA, and you do not ask SERS to do a direct transfer, the lump sum payment is subject to a 20% federal withholding rate. You or your spouse may not rollover the non-taxable portion of the lump sum payment to a 457 plan (Deferred Compensation). You may rollover the non-taxable portion of a lump sum payment to a 401(a) plan, 403(b) plan, traditional IRA or Roth IRA. The transfer must be made either through a direct rollover to a 401(a) or 403(b) plan that separately accounts for the taxable and non-taxable parts of the rollover or through a rollover to a traditional or Roth IRA.

FEDERAL & STATE INCOME TAXES

Taxation of a Retirement Annuity
Retirement annuities (pensions) paid by SERS are exempt from Illinois income tax. Pension payments are subject to federal income tax under the Simplified Method. This method states a portion of each benefit payment is taxable, and a portion is non-taxable based on the recovery of employee contributions and the age of the individual. Following the recovery of the employee contributions, the entire benefit payment and any increase to the benefit is taxable.

The amount of the monthly benefit that is non-taxable will be provided when the benefit begins. A Form 1099-R will be issued each January. If you die with no eligible survivor or nominated beneficiary to receive any death benefits that may be payable, any remaining employee contributions may be claimed as a miscellaneous itemized deduction (not subject to the 2% floor) on your final tax return.

Tax Credit for the Elderly & Disabled
A tax credit based on retirement income is available for eligible state retirees under age 65 who are permanently and totally disabled. A tax credit based on retirement income is available for eligible state retirees who are age 65 or older. The tax credit may be applied to reduce the tax liability, if any, on the retired person. Consult your local IRS office for assistance in computing this credit.

Tax Credit for Public Safety Officers
The Pension Protection Act of 2006 allows retired public safety officers to deduct up to $3,000 in premiums for health insurance coverage from their gross annual income. For more information, refer to IRS Publication #575 and the instructions for completing your IRS Form 1040.

Taxation of Disability Benefits
Occupational disability benefits paid by SERS are exempt from federal and Illinois income tax. Although exempt, these benefits are reportable and a Form 1099-R will be issued each January. Non-occupational disability and temporary disability benefits are exempt from Illinois income tax. However, these benefits are subject to federal income tax; therefore a form 1099-R will be issued each January.

Taxation of Widow’s Survivor’s Benefits
Both lump sum and monthly widow’s/survivor’s benefits paid by SERS are exempt from Illinois income tax, but these benefits are subject to federal income tax. Employee contributions paid by SERS as a death benefit before retirement are excluded from taxable income.

Contributions made after December 31, 1981 and interest on all contributions are included in taxable income and are eligible for a rollover when paid to a surviving spouse (see Rollovers section). These amounts are also eligible for rollover when paid to a beneficiary other than a spouse. When the benefit begins, SERS furnishes the beneficiary with the non-taxable amount, if any.

The monthly benefit paid to a survivor or widow, as well as the $1,000 lump sum survivor benefit and the $500 lump sum widow’s benefit, are subject to federal income tax under the Simplified Method. This method states that a portion of each payment is taxable, and a portion is non-taxable based on the recovery of employee contributions and the annuitant’s age.

Following the recovery of the employee contributions, the entire benefit is taxable. Any increase to the benefit is also taxable. Following the death of the survivor or widow, if there is not an eligible nominated beneficiary to receive any death benefits that may be payable, any remaining employee contributions may be used as a deduction on the final tax return of the survivor or widow. The amount of the monthly benefit that is non-taxable will be provided to the survivor/widow when the benefit begins. A form 1099-R will be issued each January.

Taxation of Occupational Death Benefits
Occupational death benefits, excluding the lump sum portion, are exempt from both federal and Illinois income tax. The occupational death lump sum payment consists of all contributions and interest in the member’s account. Contributions and interest are subject to federal income tax and are eligible for rollover (see the Rollovers section).

Taxation of Lump Sum Payments
Lump sum payments include:

• Non-occupational death benefit

• Non-occupational death benefit after retirement

• Refund of widow’s/survivor’s contribution

• Refund of contributions after withdrawal from service

• Alternative formula contribution refund.