TAX LIABILITY ON WRS BENEFITS

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Table of Contents

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The Department of Employee Trust Funds 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.

Cover photo courtesy of the Wisconsin Department of Tourism.

Taxation of Your WRS Benefit

This brochure provides general information about the income tax liability on your Wisconsin Retirement System benefits. The tax treatment of WRS benefits is generally similar for federal and Wisconsin income tax purposes.

- Your WRS benefit is not subject to Social Security or Medicare taxes.
- There are a few exceptions, such as retirement payments received by certain beneficiaries and some teachers, who are exempt for Wisconsin income tax purposes but not for federal purposes. See the *Payments Exempt from Wisconsin Income Tax* section on page 8.

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

Required Contributions

Your WRS retirement benefit is taxable as income; however, a small portion may be exempt from income taxes.

- *Taxable Portion of Your Payment*: Because your regular employee contributions are made pre-tax, you will pay income taxes on the portion of your annuity or lump sum that is based on those contributions.* You will also pay taxes on the portion that is based on the matching employer contributions.
- *Tax-Exempt Portion of Your Payment*: If you contributed after-tax dollars to your WRS account, that amount has already been taxed and will not be taxed again. This amount is called your investment in contract (IIC). It is shown at the bottom of the *Employee Required Contributions* section on your annual *Statement of Benefits* (ET-7365).

* The exception would be employee-required contributions made post-tax pursuant to a collective bargaining agreement or contract.

Employee After-Tax Additional Contributions

If you made additional contributions, part of your WRS benefit will be taxable and part will be exempt from taxation.

- *Taxable portion of your payment*: The portion of your payment attributable to investment earnings will be taxable. For additional contributions that are annuitized, the taxable portion is prorated over your life expectancy.
- *Tax-exempt portion of your payment*: Your actual contribution has already been taxed, so the portion of your payment attributable to that amount will be tax-exempt.

Tax-Deferred Additional Contributions Under Section 403(b) of the Internal Revenue Code

Before January 1, 2009, employees of certain school districts and other educational institution employers could make additional contributions from pre-tax earnings. The entire payment from these contributions will be taxable.

Disability Annuity

If you receive a disability annuity, contact your tax advisor, the Internal Revenue Service (IRS) or the Wisconsin Department of Revenue (DOR) for information about possible special tax treatment of your disability annuity.

Taxation of Monthly Annuities

When you apply for your annuity, be sure to complete the income tax withholding information on the retirement application.

Your application will include a IRS W-4P worksheet to help you determine your federal withholding. You can also review the federal and Wisconsin tax withholding tables online at etf.wi.gov/retirees.htm to help you decide how much to have withheld.

State of Wisconsin Tax Withholding:
Wisconsin income tax withholding is voluntary. If you do not specify how you want taxes withheld, ETF will not withhold anything.

- If you elect Wisconsin tax withholding according to the tax tables, your Wisconsin tax withholding amount will automatically adjust when the tax tables change or the amount of your annuity changes.
- If you choose to have a specific amount withheld, your amount will not be automatically adjusted when the amount of your annuity changes. If you want the amount to change, you must make the change yourself.

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 $500 or more with your Wisconsin income tax return, you should prepay your tax each year by making estimated tax payments or have sufficient withholding to avoid underpayment interest. You can obtain further information from the DOR.

Federal Tax Withholding
Federal income tax withholding is voluntary. However, if you do not specify how you want taxes withheld, federal regulations require ETF to withhold according to the tax tables assuming that you are married with three exemptions.

If you have federal tax withheld, your withholding must be based on the IRS tax tables—you cannot request a specific dollar amount.

- However, you may elect federal tax withholding according to the tax tables *plus* an additional amount.
- Unless you specifically elect not to have federal taxes withheld, the withholding amount will be automatically updated when the tax tables change or your gross payment changes.

Increased Withholding on Certain Payments
Income tax on the following payments may be withheld at a higher rate:

- retroactive increases
- back pay, such as the final calculation
- first payment to a disability annuitant
- first payment to an alternate payee. An alternate payee is the former spouse or domestic partner of a WRS member who was awarded a percentage of the member's WRS account and/or annuity by a Qualified Domestic Relations Order (QDRO).

Withholding on Payments from an Annuity Certain
An annuity certain is an annuity that pays a specific monthly amount for a set period of time. You may choose to take an annuity certain on your additional contributions but not on your required contributions.

- Unless you do a direct rollover into an eligible employer plan or an IRA, ETF must withhold 20% of the taxable portion of monthly payments from an annuity certain of less than ten years.
- If you take an annuity certain before turning 59½, you may be assessed state and federal penalties. Please contact a tax advisor, the Wisconsin DOR or the IRS for information.

If you begin an annuity certain of less than 10 years in the year in which you reach age 70½ or later, a portion of your benefit is considered a required minimum distribution (RMD) under federal law.

- Federal taxes will be withheld at 10% on the RMD amount unless you indicate otherwise. The mandatory 20% withholding applies only to the portion of your benefit in excess of that amount.
- You cannot rollover the RMD amount. The RMD must first be distributed to you as taxable income and the remainder can be rolled over tax deferred.

(See page 6 for more information on the required minimum distribution.)

Changing Your Withholding

To change your income tax withholding:

- Use the ETF Retiree Monthly Tax Withholding Calculator to help you determine how much to withhold from your annuity payment for taxes. Access the calculator at https://trust.etf.state.wi.us/ETFTaxCalculator/calculator.do.
- Complete and return the *Income Tax Withholding Election Change for Monthly Annuities* (ET-4310) form, available online or by contacting ETF.

1099-R Statement

If you are a U.S. Citizen or a resident alien, ETF will send you a 1099-R statement annually by January 31, providing information necessary to complete your tax return. You do not need to request this information.

The 1099-R will provide:

- the annual gross amount of your benefit payment(s),
- the taxable portion of your WRS distribution(s) and
- the total amount withheld for life and health insurance premiums, and federal and Wisconsin state income taxes, if any.

If you have more than one WRS annuity account (for example, you receive an annuity from both your own WRS account and as a beneficiary of another account), you will receive a separate annual 1099-R tax statement for each of your annuity accounts.

It is important that you file copies of all your 1099-R forms with your annual tax returns, if required by the taxing authority. The 1099-R forms will be mailed in separate envelopes and may arrive on different days.

If you are receiving monthly payments in the year in which you turn 59½, IRS regulations require ETF to provide you with two 1099-R statements for that calendar year. One will reflect the income you received for the time you were under 59½ years of age. The other will reflect the income you received after you turned 59½.

1042-S Statement

If you are not a U.S. citizen and you do not reside in the United States, ETF will send you a 1042-S statement annually by March 15, in lieu of a 1099-R.

W-2 Wage and Tax Statements

You may receive a W-2 from ETF if you are covered under the state's Group Health Insurance Program and you:

- receive a Wellness Incentive from your health plan. These incentives are taxed as ordinary income. Although ETF will provide you with the W-2, if you have questions or concerns about the incentive amount or the taxable portion, you must contact your health plan directly.
- cover a non-tax dependent on your health insurance contract and use sick leave credits to pay your premiums. The portion of the premium that covers non-tax dependents is considered imputed income and is taxable. This does not apply to you if your premiums are deducted from your annuity because those premiums are paid post-tax.

Taxation of Lump Sum Benefits

If you do not roll over your lump sum payment, ETF must withhold 20% of the taxable portion of your payment for federal income tax. ETF does not withhold state taxes from lump sum payments.

Early Distribution Tax

If you are younger than age 59½, you may be subject to a 10% additional income tax penalty on early distributions for any payment from the WRS (including amounts withheld for income tax) that you do not rollover, unless an exception applies. This tax is in addition to the regular income tax on the payment not rolled over.

- When there is a federal additional tax, you may also owe an additional state tax, depending on the state you live in. In Wisconsin, the additional tax is 33% of the federal 10%, so it is 3.33% of the taxable gross benefit.
- Contact your tax advisor or the IRS for details about possible 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. (See page 6 for more information regarding rollovers.)

1099-R Statement:

By January 31, ETF will send you a 1099-R statement providing information about your lump sum payment that is necessary to complete your tax return. You do not need to request this information.

The 1099-R will provide:

- the gross amount of your benefit payment,
- the taxable portion of your WRS distribution and
- the total amount withheld for life and health insurance premiums, and federal and Wisconsin state income taxes, if any.

Required Minimum Distribution

If you are no longer working under the WRS and are not yet receiving a WRS retirement benefit, you must receive a disbursement known as a required minimum distribution (RMD) each year, beginning with the year in which you reach age 70½.

- ETF will notify you in the year you turn 69½ of your options to apply for your benefits, rollover your benefits to another qualified plan or to defer your benefits until March 1 of the calendar year you reach 71½.
- If you do not respond by December 31 of the year you reach 69½, ETF must make an automatic distribution of the entire account balance on or after the next January 1. This could result in a tax consequence, an effective date or type of payment that you do not want. It is important for you to contact ETF before an automatic distribution is required.
- If you do not take your RMD by April 1 in the year you turn 71½, or by December 31 of the year you end employment (if you continued working under the WRS after you reached age 70½), you may be required to pay a federal tax of 50% of the RMD amount that you should have received during that tax year.

If your covered WRS employment will end when you are 70½ or older, you should request your WRS annuity estimate up to one year in advance and begin your benefit during that year. Contact the IRS or your tax advisor for more information on the RMD.

Rollovers

You may rollover all or part of your lump sum payment or annuity certain of less than ten years to:

- a traditional IRA [408(a)]
- a Roth IRA [408(b)]
- an eligible qualified employer plan [including plans under IRC sections 401(a), 401(k), Roth 401(k), 403(a), 403(b), Roth 403(b), 457(b) and Roth 457(b)]

If you have questions on whether or not your WRS funds are eligible to be rolled over into another qualified plan, you should contact that plan administrator directly.

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 you do not do a direct rollover, ETF must withhold 20% of the taxable portion of your payment for federal income tax.

- You cannot rollover a lump sum benefit of less than $200. The 20% federal tax will not be withheld on the distribution.
- Alternate payees have the same rights as WRS employees to rollover their benefit.

There are two ways to do a rollover. You can do either a direct rollover or an indirect rollover.

- *Direct rollover*: If you do a direct rollover, please complete the *Authorization for Direct Rollover* (ET-7355) form and return it to ETF along with your benefit application. ETF will make the payment payable directly to the receiving plan. ETF will send the check to you, and you must send it to the receiving plan.
- *Indirect rollover*: To do an indirect rollover, you must deposit the funds into the receiving plan within 60 days of receiving the payment from ETF. If you do not rollover the entire amount of the payment, the portion not rolled over will be taxed and will be subject to the 10% additional income tax on early distributions if you are under age 59½ (unless an exception applies).

Taxation of Death Benefits

If you are a beneficiary of a deceased WRS member, the death benefit application will indicate if you are eligible to choose either a monthly or lump sum benefit, or if you are restricted to one method of payment.

Monthly Annuity Death Benefits
Monthly death benefits are taxable except for the portion that has already been taxed. The non-taxable portion of the death benefit, if any, is based on several factors:

- the original non-taxable portion;
- 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.

How your monthly non-taxable amount is calculated depends on whether or not you are a named joint survivor.

- For a death benefit paid to a named joint survivor, the WRS member's monthly non-taxable portion continues to be reported as the non-taxable amount for the joint survivor.
- For death benefits paid to other beneficiaries, the entire gross annuity will be reported as non-taxable until the non-taxable balance is zero. Once the WRS member's non-taxable portion balance is zero, then the entire gross annuity is reported as taxable.

State of Wisconsin Tax Withholding on Death Benefits
Wisconsin income tax withholding is voluntary. If you do not specify how you want taxes withheld, ETF will not withhold anything.

- If you elect Wisconsin tax withholding according to the tax tables, your Wisconsin tax withholding amount will automatically adjust when the tax tables change or your annuity amount changes.
- If you choose to have a specific amount withheld, your amount will not be automatically adjusted when the amount of your annuity changes. If you want the amount to change, you must make the change yourself (see Changing Your Withholding on Page 4).

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 $500 or more with your Wisconsin income tax return, you should prepay your tax each year by making estimated tax payments or have sufficient withholding to avoid underpayment interest.You can obtain further information from the Wisconsin DOR.

Federal Tax Withholding on Death Benefits
Federal income tax withholding is voluntary, but 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.

- If you choose to have federal tax withheld, your withholding must be based on the IRS tax tables; 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 specifically elect not to have federal taxes withheld, the withholding amount will be automatically updated when the tax tables change or your gross payment changes.

Lump Sum Death Benefits
If you are eligible to rollover your benefit, and do not, ETF must withhold 20% of the taxable portion of your payment for federal income tax. ETF does not withhold state income taxes from a lump sum death benefit, so you may want to keep part of your payment for any state income tax that you will owe (if taxable by your state of residence).

Taxation of Death Benefits (continued)

Rolling Over Lump Sum Death Benefits
You may rollover your lump sum payment if you are:

- The spouse of the WRS account holder.
- Not the spouse of the WRS account holder, and you are receiving this payment because that person named you on a beneficiary designation form filed with ETF.
- Not the spouse of the WRS account holder and you are receiving this payment as a beneficiary of that person under s. 40.02 (8) (a) 1. or 2., Wisconsin Statutes.
- A trust with specific, named beneficiaries who were named by the WRS account holder.

You may not rollover your lump sum payment if you are:

- Receiving this payment from the WRS account holder's estate, either by the terms of a will or through intestacy under s. 852.01, Wisconsin Statutes.
- The beneficiary of someone who received this account from the WRS account holder.

Where you may rollover your lump sum depends on whether you are a spouse or a non-spouse beneficiary.

- If you are a spouse beneficiary, you may roll your lump sum death benefit into a traditional [408(a)] or Roth [408(b)] IRA, Section 403(b) tax-sheltered annuity, Section 457 governmental deferred compensation plan or other eligible employer plan.
- If you are a non-spouse beneficiary, you may only roll your lump sum death benefit into an inherited IRA.

You may not roll your lump sum payment into your own WRS account.

Payments Exempt from Wisconsin Taxes

Some payments received from the WRS are exempt from Wisconsin taxes. However, these payments are not exempt from federal taxes.

- Payments from the account of a person who was a member of (or retired from) the State Teachers Retirement System or the Milwaukee Teachers Retirement Fund as of December 31, 1963 are exempt from Wisconsin taxes.
- This exemption also applies to:
  - a beneficiary of a person who was a member of, or retired from, one of these systems as of December 31, 1963.
  - an alternate payee (under a QDRO) if their former spouse or domestic partner qualified for this exemption.
- 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 DOR for details.

For More Information

For more information about the taxation of retirement benefits, you should:

- contact your tax advisor,
- see IRS Publication 575, and/or
- contact the Wisconsin Department of Revenue or your state's tax agency.

Contact ETF

Visit us online at etf.wi.gov

Find Wisconsin Retirement System benefits information, forms and publications, benefit calculators, educational offerings, email and other online resources.

Call us toll free at 1-877-533-5020 or 608-266-3285 (local Madison)

Benefit specialists are available by phone 7:00 a.m. to 5:00 p.m. (CST) Monday-Friday

Wisconsin Relay Service for hearing and speech impaired: 7-1-1
1-800-947-3529 (English), 1-800-833-7813 (Spanish)

Write or Return Forms

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Madison, WI 53707-7931

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