To: P&G Employees
From: John B. Cornetet, CPA, J.D., CFP 513-771-2444

Re: Distribution Options

When you retire, you may elect to keep your PST in P&G Plus. However, if you take your plan assets from P&G, you have three options: lump sum distribution, IRA rollover, and partial rollover.

<u>Lump Sum Distribution</u>
The IRS defines a lump sum distribution as a full distribution of your entire account in one taxable year. The distribution must be made because of:

1. death, or
2. after age 59 1/2, or
3. on account of your separation from service

You must pay ordinary income tax (10% - 35%) on the cash, funds, and on the cost basis of the P&G stock received. This method produces the lowest income tax burden of all methods. For example, a client has 15,000 shares with an average employers cost basis of $15 per share and the fair market value is $90 per share. Because you are receiving P&G stock, you may pay a one time income tax on the $15. After age 55, no 10% penalty rule applies, no substantial equal payment rules and no minimum distribution rules at age 70 1/2. You are done with income taxes unless you sell P&G shares. The gain over the basis of $15, is taxed at capital gain rates which are now 5% to 15%. The total tax cost would be approximately $56,000 (15,000 X $15 X 25%) on the withdraw of $1,350,000 worth of P&G stock. That is a tax of 4% federal. You must also pay state income tax on the $15 per share cost.

There is a special ten year averaging method for participants who were born before 1936.

The downside of this plan is that all of your eggs are in one basket. Your retirement funds are all in P&G stock. I have only had several clients do a lump sum distribution primarily because of the diversification risk. If you have a diversified portfolio outside of P&G or your spouse has assets and a steady pension, this may work well for you.

Certainly you can diversify out of P&G stock. However, you will pay capital gains taxes along the way. Again, with rates so low, this method may still produce a very low total tax cost. If my client sold all of the P&G stock the day after receipt to full diversify, the capital gains tax would be $169,000. ($90 - $15 X 15,000 shares X 15%). This pushes the total federal tax cost on the fully diversified account of 17%. ($56,000 + $169,000 / $1,350,000).

<u>IRA rollover</u>
This method moves all of your PST from P&G to an IRA custodian. This is called a Trustee to Trustee rollover. No taxes are paid until you withdraw the money in the future. If you did not need the funds, you could delay income taxes on the IRA until you attain the age of 70 1/2. In the example outlined above, the tax money $225,000 would stay in the IRA and continue to work

for you until you withdrew it. If you do not do a Trustee to Trustee rollover, you must take receipt of the distribution and then roll it into an IRA within sixty days of receipt. However, P&G will withhold 20% federal taxes out of the cash portion. Because of this withholding requirement, everyone does a Trustee to Trustee rollover.

All of the rules apply to IRAs. The 59 1/2 rule, the substantial equal payment rule and the minimum distribution rules at age 70 1/2. The rules are as follows:

<u>prior to 59 1/2</u> - you must pay income tax on the amount withdrawn at ordinary income tax rates. You must also pay a 10% penalty unless you fit an exception. They are death, disability, divorce and the substantial equal payment.

<u>age 59 1/2 to age 70 1/2</u> - you may take out as much or as little (unless you are continuing your SEP). Taxes at ordinary rates are paid as withdrawn.

<u>after age 70 1/2</u> - You must start a plan to withdraw your IRA over your life expectancy. As you get older, your divisor gets smaller and you have massive forced distributions from your IRA and will likely pay the highest ordinary income tax rates.

The advantage of the IRA is the ability to diversify and the ability to defer income taxes. While you are deferring the taxes, the tax rate may be much higher upon withdraw. Compare 4% - 17% obtained with the lump sum distribution and partial rollover with 35% likely due on the IRA.

<u>Partial Rollover</u>
A partial rollover is a lump sum distribution (taking it all away from P&G in one taxable year) followed by a partial rollover into an IRA. Remember the client with 15,000 shares. He may take a lump sum distribution, keep 5,000 share which would be taxed at the cost basis and rollover the 10,000 shares into an IRA. This is in many cases the best of both worlds. Some stock is taxed at very low rates and some is rolled into an IRA.

<u>Conclusion</u>
The right answer for you depends upon a number of factors. Some of these factors include, your age, the size of your account, your financial needs, your family needs, and your goals. There is no one right answer or formula. You need to consider your situation from the following three perspectives:

1. What is the right answer from the income tax perspective?
2. What is the right answer from the estate planning perspective?
3. What is the right answer from the financial planning perspective?

In many cases there is a different right answer for each question. It then turns to a balancing act based upon your goals and objectives.

Commercial: Retain someone who understands all three perspectives as a part of your team!!