Cornetet, Meyer,
Rush & Kirzner
ATTORNEYS AT LAW

123 Boggs Lane
Cincinnati, Ohio 45246
www.cmrklaw.com
Phone (513) 771-2444
Fax (513) 771-2447

jcornetet@cmrklaw.com
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Retirement Plan Distribution Choices

The strategy you should consider and the options and rules that apply to your P&G retirement plan depends on your age at the point of separation from service. With this guide, you can narrow your choices and focus on options available to you based on your age and financial need. You only need to read the section that applies to you. Further, whether you need access to your retirement account before age 591/2 is also a major factor. I have outlined your choices below based on these factors.

Do not make financial decisions before consulting a tax advisor. This guide does not constitute legal or tax advice. As you will see, there are options available for each group and what is right for you depends on you unique situation. Therefore, you should consult an advisor concerning your situation.

The three possibilities are:

Not age 55 at the point of separation from service.
Age 55 to age 591/2 at the point of separation from service.
Age 591/2 or older at the point of separation from service.

Definitions

Before you read your section there are two definitions or methods that need to be explained.

NUA Method - NUA stands for Net Unrealized Appreciation. P&G has kept track of the cost of the shares in the Plan. The basis in the preferred is as low as $6.84. The basis in the common is as low as $10. Your basis may be higher. Under the NUA method, you have the opportunity to take P&G stock from the Plan and pay tax on the $6.82 or $10.00 rather than the fair market value of $65. The NUA method is only available on P&G stock. Most retirees take advantage of this method at some level because of the extremely low tax cost.

Substantial Equal Payment Plan SEPP (72t) - The rule requires you to take the same amount from an IRA every year for five years or until you reach age 591/2, whichever is longer. If you set up a SEPP, there is no 10% penalty. There are three formulas you may use to calculate the amount. Once the amount is set there is no way to change it until the SEP is over. Once you reach age 591/2 or five years, the plan is over and you can take any amount out of your IRA without penalty.

Not age 55 at the point of separation from service

The next question to answer is whether you will need money from your retirement assets prior to age 59½. The choices available will be different based on the answer.

<u>I will not need money before age 591/2.</u>

The problem with needing money before age 591/2 is that you will incur a 10% penalty on top of the income tax on any distributions you take before age 591/2. Thus, if you don't need access to your retirement account, you do not need to worry about the 10% penalty.

Keep it all at J. P. Morgan - The question for you becomes more of a financial planning question. The question is: am I satisfied with the investment choices provided by J.P. Morgan and the requirement of keeping 40% invested in P&G stock or do I think I can make better investment choices in an IRA? If your answer is that J.P. Morgan funds are fine, then leave your money at J.P. Morgan. You are done with your planning, except to consider whether, how, and when to diversify within J.P. Morgan.

Rollover all or some to an IRA - If you think your money would be better invested outside of J.P. Morgan then you will want to rollover some or all of your retirement account into an IRA. In an IRA there is no requirement to hold 40% in P&G stock. Further, you may employ a money manager to give you professional assistance on money management matters. There is no limit as to the investment opportunities available in an IRA.

If you decide to rollover your money into an IRA, you have two choices:

Full IRA rollover - Rollover 100% of your retirement plan and savings plan into an IRA. By doing this, you are giving up the ability to take out a block of P&G stock and paying the tax on under the NUA method. **If you rollover all of your retirement account into an IRA, you cannot take advantage of the NUA method.**

Partial rollover – Roll some of your retirement plan into an IRA at separation followed by a lump sum distribution of the rest after age 591/2. Assume you have $1,200,000 and you want to take out $200,000 using the NUA method. At the point of separation from service, rollover $1,000,000 onto an IRA and diversify that portion. Then at age 591/2, take out the $200,000 in P&G stock under the NUA method. The fact that you keep $200,000 in P&G stock at J.P. Morgan doesn't mean you have to use the NUA method. It simply means you have kept the opportunity open. At or after you reach age 591/2, you can decide to: rollover the entire $200,000 into your IRA; take the whole $200,000 block of stock under the NUA method; or anywhere in-between. **It is generally a good idea to preserve this opportunity depending on your circumstances.**

I will need money before age 591/2.

In order to have access to your money, you will have to pay income tax on any withdraw at your normal income tax rate and a 10% penalty for early withdraw. There are exceptions to the penalty and options that you need to explore.

Pay the Penalty - Take money as needed and pay the 10% penalty – The 10% penalty may not be that bad. For example, if you needed a onetime distribution of $50,000 to pay off your mortgage, the penalty is only $5,000. It may be better to just pay the $5,000 than to set up a substantial equal payment for five years to avoid the penalty. Yes, there is a penalty, but it is the best financial choice. Typically, if you need money every year until age 591/2 this may not be the best approach. It may work well for the onetime payment need. You can do this either at J.P. Morgan or in an IRA.

Partial rollover – live on the stock - Do a partial rollover and live off of the P&G stock until age 591/2 – Assume you have $1,200,000 in your plan and you need $200,000 to get you to age 591/2. You would rollover into an IRA $800,000 and take $400,000 out in P&G stock under the NUA method. You would pay income tax on the cost basis of $6 to $10 per share. Additionally, you only pay the 10% penalty on the taxable amount, not the fair market value. If we assume the cost is $10 per share, then you include in income about $60,000 and the penalty would only be $6,000. Even with the penalty, the taxes are very small. Then you sell P&G stock over the next few years to supplement your budget. Do not touch the IRA until you reach age 591/2. You must take your retirement account away from J.P. Morgan to do this method.

Note: if you do the Frank Duke method, there is no income tax on the P&G stock when it comes out of the plan and therefore, no 10% penalty. The penalty is 10% of the taxable amount which would be zero.

Partial rollover – live on the IRA - Do a partial rollover and live off of the IRA until age 591/2. Assume you have $1,200,000 in your plan. Keep $200,000 at J. P. Morgan until you reach age 59 ½ and rollover into an IRA $1,000,000. Establish a SEPP on the IRA. Once you reach age 59 ½, you could use the NUA method on the $200,000 at J. P. Morgan or roll it into your IRA.

Age 55 to age 591/2 at the point of separation from service

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<u>I will need money before age 59½.</u>

Leave it all at J. P. Morgan - One advantage with the J.P. Morgan plan is that you can take out **ad hoc distributions** during this time frame without a 10% penalty. The penalty only applies to IRAs, not profit sharing plans. Under an ad hoc distribution, you may take out any amount without establishing a five year substantial equal payment. In year one you can take out $50,000, in year two take out nothing, and in year three take out $80,000. Simply take it as you need it without a 10% penalty.

Partial rollover – live off J.P. Morgan - You can do this method even if you want to roll some of your money into an IRA now to start your diversification plan. For example, you have $1,200,000 in the plan. If you rollover $800,000 into an IRA and leave $400,000 at J. P. Morgan, you can do ad hoc distributions on the $400,000 left at J. Morgan. Then at age 591/2, you can rollover any excess not taken in ad hoc distributions or use the NUA method.

Age 591/2 or older at the point of separation from service

You have full access to your retirement account whether it stays at JP Morgan or is rolled into an IRA. You pay income tax on money as you take it. However, you never need to worry about the 10% penalty for early withdraw. Thus, you face the normal retirement decisions that anybody else faces.

Do I have enough to retire?

Do I want to keep it at JP Morgan or roll it into an IRA?

Do I want to manage the money myself or employ a money manager?

Do I want to use the NUA method for some of my retirement account?

How and when do I want to diversify my retirement account?

Watch out – Before you take out one dollar after age 591/2, you better establish a game plan.

Once you take any distribution from the plan (other than dividends) you only have that calendar year to take a lump sum distribution and use the NUA method. For example, you take out $20,000 in 2012. In 2013, you plan to do a lump sum distribution and use the NUA method. You blew it! Once you take the first distribution in 2012 that made 2012 the only year you can do the NUA method. In order to use the NUA method all of the account must come out of JPMorgan in one calendar year.

As you can see the decisions is dependent on your age and circumstances. If you would like to review your particular situation, please feel free to call me.

John B. Cornetet