The IRA Rollover

Making Sense Out of Your Retirement Plan Distribution

Expecting a Distribution?

You have been a participant in your employer's retirement plan for a number of years, and you have earned your vested retirement benefits. A distribution from a qualified plan not only represents your vested interest in the plan; it may also represent a substantial source of future retirement funds. You should, therefore, be aware of the options now available to you and how each of those options will affect the amount of tax you will pay and when you will pay it. Also, current tax laws could have a significant impact on your retirement planning. An employee receiving an **eligible rollover distribution** from a **qualified trust** must be given the opportunity to have his or her employer's plan administrator directly transfer the distribution to an **eligible retirement plan.*** Morgan Stanley Smith Barney is prepared to receive most distributions directly into the Morgan Stanley Traditional IRA. If you choose to receive the distribution, the plan administrator **must** withhold up to 20% of the value of the distribution for Federal income taxes.

*An "eligible retirement plan" is a Traditional IRA, another employer's qualified retirement plan, a 403(b) plan or a governmental 457 plan. A Roth IRA is an "eligible retirement plan" and may receive a rollover contribution from an employer's retirement plan including a 401(k), 403(b) or government 457(b) plan. Distributions from qualified retirement plans, 403(b) plans and government 457(b) plans may be rolled over directly to a Roth IRA without the need to deposit the distribution in a Traditional IRA before making a transfer to a Roth IRA.

Tax laws are complex and subject to change. Morgan Stanley Smith Barney LLC, its affiliates, and Morgan Stanley Smith Barney Financial Advisors do not provide tax or legal advice. This material was not intended or written to be used for the purpose of avoiding tax penalties that may be imposed on the taxpayer. Individuals are urged to consult their personal tax or legal advisors to understand the tax and related consequences of any actions or investments described herein.

Eligible rollover distribution

An **eligible rollover distribution** is any distribution to an employee of all or any portion of the balance to his or her credit in a qualified trust, a 403(b) plan or a governmental 457 plan, except for distributions which are either:

1. Part of a series of substantially equal periodic payments made at least annually for the life or life expectancy of the employee or the joint lives or life expectancies of the employee and the employee's designated beneficiary;
2. Part of a series of substantially equal periodic payments made at least annually and initially scheduled to continue for a specified period of 10 years or more;
3. Minimum required distribution amounts paid to employees who have attained age 70½; or
4. Certain deemed distributions, loans and hardship withdrawals.

Your options

Based upon your age and anticipated retirement needs, you may opt to pay taxes now, subject in some instances to special tax treatment. You may, on the other hand, choose to "roll" your retirement plan distribution into an Individual Retirement Account if the distribution is an "eligible rollover distribution" (defined above). An "IRA Rollover" will postpone any current tax liability and give your assets the chance to grow tax-deferred until distributed. You might also decide to roll only a portion of your distribution into an IRA and pay any taxes due on the portion not rolled over.

Caution

If you are younger than age 59½, any portion that is not rolled over may be subject to a 10% Federal penalty tax in addition to the tax on the distribution. An exception to this penalty applies if you separate from service during or after the year you attain age 55.

Eligible rollover distributions may include after-tax or nondeductible contributions. However, an eligible rollover distribution may be rolled over to a qualified employer's plan, a 403(b) plan or a governmental 457(b) plan only if the receiving plan agrees to accept the rollover distribution.

Special tax treatment

If you are receiving a lump-sum distribution and you were age 50 or over on January 1, 1986, you may be eligible for special tax treatment called 10-year forward averaging. A lump-sum distribution is defined as the payment within one taxable year of the entire balance to your credit under all qualified retirement plans* of the same type maintained by your employer. In addition, you had to be a participant in the plan for at least five years prior to the year of distribution and you must be at least age 59½ when you receive the distribution. Special tax treatment may only be elected once in your lifetime.

Additionally, long-term capital gains treatment on pre-1974 plan accumulations is also available if you meet the above requirements.

Depending upon your tax bracket and size of your lump-sum distribution, special 10-year forward averaging or capital gains tax treatment could significantly reduce the amount of income tax you would pay on your lump-sum distribution.

Exceptions

Lump-sum distributions from 403(b) plans or governmental 457(b) plans and distributions of deductible employee contributions are not eligible for

*Does not include 403(b), SEP or SIMPLE IRAs, or 457(b) plans.

special tax treatment but are eligible for rollovers. Also, if you roll over any part of a lump-sum distribution from a qualified plan, you may not apply special tax treatment to the balance.

A lump-sum distribution as a result of plan termination is not eligible for the special tax treatment unless you are over age 59½ or disabled at the time you receive it. However, a distribution received as a result of plan termination will qualify for rollover treatment.

Tax-treatment of employer securities

If your lump-sum distribution includes securities of your employer, you may be eligible for favorable tax treatment on those securities. The amount included as ordinary income will be your cost basis in the securities. This is your only tax liability until you sell the securities. Your cost basis will be increased by any after-tax contributions you made to purchase employer securities.

When the securities are sold, you will be taxed on the difference between the sale price and the cost basis. The difference, if any, between your cost basis and the fair market value of the securities on the distribution date—known as Net Unrealized Appreciation ("NUA")—is always taxed as a long-term capital gain. Any other gain is taxed under the capital gain rules depending on the time it is sold after the distribution date. If you roll over employer securities to an IRA you will lose the ability to apply this special tax treatment to your employer securities. When later distributed from your IRA, all securities are taxed as ordinary income at fair market value as of the distribution date.

You may roll over a portion of your distribution (for example, cash or other property) and still claim special tax treatment for employer securities that you do not roll over.

Example

In September, you receive a lump-sum distribution of 1,000 shares of your employer's stock. You sell the 1,000 shares in January of the following year: The cost of the securities is $10/share; the fair market value on the date of distribution is $30/share; and the sale price of the securities in January is $45/share. Based upon this example, the tax calculation is as follows:

Cost Basis

$10/share x 1,000 shares = $10,000

Tax is due for the year in which you receive the distribution.

Net Unrealized Appreciation ("NUA")

Fair market value on date of distribution minus average cost.

$30/share – $10/share = $20/share NUA

$20/share x 1,000 shares = $20,000

Taxed as long-term capital gain in the year the stock is sold.

Short-Term Capital Gain

Sale price minus cost basis and NUA on the date of distribution.

$45 – $30 = $15/share

$15/share x 1,000 shares = $15,000

Taxed as short-term capital gain in the year the stock is sold.

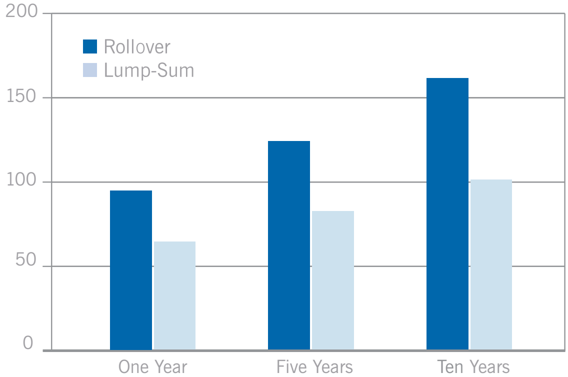
Note: The length of time the stock is held after distribution will determine the capital gain treatment.

Rollover Individual Retirement Account

A tax-free transfer of your distribution into a Rollover IRA is an alternative for your lump-sum distribution. The Rollover IRA is designed to defer taxation on lump-sum distributions until withdrawals begin. In addition, no taxes are paid on any earnings within the account until funds are distributed to you. As funds are withdrawn from a Rollover IRA, they are taxed at your ordinary income tax rate.

Since you pay no current taxes, the entire Rollover amount may be put to work for you. The Rollover account allows your assets and any earnings an opportunity to grow tax-deferred until distributed. This tax deferral can be a very valuable advantage, as shown by the chart below.

Rollover vs. Lump-Sum Distribution



Hypothetical illustration that is not representative of any specific investment.

The dark blue bars on the chart above represent a $90,000 lump-sum distribution with all taxes deferred through an IRA Rollover. An annual 6% investment gain is assumed. The light blue bars represent the same $90,000 lump-sum distribution that is not rolled into an IRA Rollover. Initially, 28% in income taxes is paid ($90,000–$25,200). Investment gains are projected annually at 6%, subject to a 25% income tax.

Note: The funds in the IRA Rollover will be subject to ordinary income tax as they are withdrawn and may be subject to a premature distribution tax penalty if you are under age 59½. Also, this example does not take into account any state or local income taxes that may apply.

Rollover deadline

In order to take advantage of the tax-deferred Rollover rules, you must roll your distribution into an IRA within 60 days of receipt. If you receive your distribution in a series of payments scheduled to last less than 10 years (and not based on life expectancy), you have 60 days from each payment to roll over each payment.

As we discussed above, you may elect to have your distribution directly rolled over to your IRA. If you do not, you may still complete the rollover within 60 days but your employer's plan administrator will withhold 20% of the taxable portion of your distribution for Federal income taxes. You may roll over the full value of the distribution but you must "gross up" the 20% that was withheld with cash from another source to complete the rollover within the 60-day period. You may not wait until you receive a tax refund and then complete your rollover. Eligible amounts that are not rolled over, including the 20% withholding, will be subject to current taxes and, if you are under age 59½, the 10% premature distribution tax penalty may also apply.

Contributions

All of your employer's contributions to the retirement plan plus your own contributions and earnings on all contributions may be rolled over. Nondeductible or after-tax contributions may only be rolled over to an IRA or a qualified employer plan that segregates or separately accounts for the after-tax contributions by a direct rollover.

There is no maximum age limitation for rollovers. Unlike Traditional IRA contributions, which are not permitted after age 70½, an individual may establish a Rollover IRA at any age. However, if an individual establishes a Rollover IRA after reaching age 70½, distributions must begin immediately as described under "Withdrawals."

Partial rollovers

You do not have to roll over your entire eligible rollover distribution. You may choose to use part of the funds to cover current expenses, and roll the rest into an IRA. Taxes will be deferred on the portion rolled over, and ordinary income tax will be due on the amount not rolled (other than nondeductible employee contributions, which are returned tax-free). There is no special tax averaging treatment allowed for the portion that is not rolled into an IRA and any taxable portion not rolled over will be subject to the mandatory 20% withholding for Federal income taxes and ordinary income tax at your marginal rate.

Distribution from more than one plan

Each separate distribution received from two or more plans in the same year may be rolled over, in whole or in part, so long as each distribution is an eligible rollover distribution (see definition of eligible rollover distribution on page 2). However, if you roll over any part of a lump-sum distribution you will lose the ability to apply special tax treatment (discussed on page 3) to all lump-sum distributions from the same kind of plan (e.g., all pension plans) received in the same year.

Withdrawals

You may withdraw funds from your IRA Rollover at any time. However, prior to age 59½, taxable withdrawals from an IRA Rollover will be subject to a nondeductible 10% premature distribution Federal penalty tax (i.e., 10% of the taxable amount withdrawn) in addition to ordinary income tax on the amount withdrawn.

However, upon death or disability of the Rollover owner, the funds can be withdrawn at any age without penalty. This penalty may also be avoided if the withdrawn amount is used to pay unreimbursed deductible medical expenses; is used to pay health insurance premiums to cover you and your dependents during certain periods of unemployment; is used for first-time home purchases ($10,000 lifetime maximum); is used for qualified higher education expenses; or if the withdrawals are made in substantially equal payments over the life expectancy of the IRA owner or the joint life expectancy of the IRA owner and his or her named beneficiary. If you are under age 59½ and need annual income, periodic payments from your Rollover IRA that satisfy Internal Code section 72(t) will minimize your tax liability.

After you reach age 59½, you may withdraw funds from your IRA Rollover at any time and in any amount. However, by April 1 following the year that you attain age 70½, the Internal Revenue Service requires that you begin taking minimum distributions. The current minimum distribution rules make it simpler to calculate distributions and, for many taxpayers, produce smaller required amounts spread over a greater number of years. The amount of the distribution may be calculated using the Uniform Table set forth on page 10.

Uniform table

Age	Factor	Age	Factor
70	27.4	93	9.6
71	26.5	94	9.1
72	25.6	95	8.6
73	24.7	96	8.1
74	23.8	97	7.6
75	22.9	98	7.1
76	22.0	99	6.7
77	21.2	100	6.3
78	20.3	101	5.9
79	19.5	102	5.5
80	18.7	103	5.2
81	17.9	104	4.9
82	17.1	105	4.5
83	16.3	106	4.2
84	15.5	107	3.9
85	14.8	108	3.7
86	14.1	109	3.4
87	13.4	110	3.1
88	12.7	111	2.9
89	12.0	112	2.6
90	11.4	113	2.4
91	10.8	114	2.1
92	10.2	115+	1.9

Since the IRS Life Expectancy Tables are based on whole years, your attained age in the calendar year you reach age 70½ may be either age 70 or 71, depending on your age on your birthday in that year.

Minimum distributions are amounts equal to the result of dividing your IRA account balance on December 31 of the prior year by the life expectancy factor found on the Uniform Table next to your age on your birthday in the year for which your distribution must be taken.

An exception to this rule applies if your sole beneficiary is your spouse who is more than 10 years younger than you. If you are eligible, your minimum distributions are calculated using your joint life expectancy found on the joint life expectancy table in IRS Publication 590.

For example, if you and your beneficiary's joint life expectancy is 30 years, the minimum distribution would be 1/30 of the value of your IRA Rollover as of the beginning of the year. You now have until April 1 of the following year to actually make the first withdrawal.

It is important to assure that these minimum distribution requirements are met. Insufficient distributions after age 70½ will result in a 50% Federal penalty tax on the amount by which the distribution fell short of the required minimum.

For the tax year in which you attain age 70½ you have until the following April 1 to make the minimum withdrawal. However, for subsequent years, the minimum amount must be withdrawn by December 31.

Taxation of withdrawals

As you receive distributions, you will be required to pay ordinary income tax on the taxable amount received. Tax on the assets and investment earnings remaining in the IRA will continue to be deferred until withdrawals are made.

Borrowing IRA assets prohibited

If you borrow money from your IRA Rollover or use IRA Rollover assets to invest in a business you own or a vacation property you may use, it will cease to be an IRA as of the first day of that tax year. Once this happens, you must include the fair market value of all the Rollover's assets used as security or collateral in your gross income for the year and pay ordinary income taxes on the entire amount. In addition, you may have to pay the 10% Federal penalty tax on premature distributions if you are less than age 59½.

If you pledge all or part of your IRA Rollover as collateral, the portion pledged will be considered a distribution from the IRA and, therefore, subject to ordinary income tax and possibly a 10% premature penalty tax if you are under age 59½.

Taxation of IRA Rollover withdrawals

When withdrawal is made:	Tax due on amount that can be included in income*
Under age 59½.	Ordinary income tax plus 10% penalty tax for premature withdrawal.
Under age 59½ upon death or total disability; substantially equal payments over IRA owner's life expectancy; deductible medical expenses; or health insurance premiums while unemployed. Distributions for first-time home purchases and for higher education expenses may also be penalty free.	Ordinary income tax only.
At least 59½ but under age 70½.	Ordinary income tax only.
After attaining age 70½.	Ordinary income tax only. However, if the minimum IRS withdrawal requirements are not met, there will be a 50% penalty tax on the difference between the required withdrawal amount and the amount actually withdrawn.

*Your IRA account(s) may contain deductible and nondeductible contributions. Please consult your tax advisor for taxation of distributions in this event.

IRA Rollover tax benefits after 70½

While you are required to begin mandatory minimum withdrawals after you attain age 70½, the IRA Rollover's tax benefits do not end. Undistributed IRA assets may continue to accumulate earnings on a tax-deferred basis.

IRA Rollover beneficiaries

You may name any individual or individuals as beneficiary of your IRA assets. In addition, you may name a trust or your estate as beneficiary. However, if you are married and live in a community property state (including but not limited to Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin), your spouse must consent to any nonspousal beneficiary designation of more than 50% of the value of the account. The named beneficiary of your IRA Rollover will receive the assets remaining in the account upon your death.

If your spouse is a designated beneficiary, he or she will have one of several options:

- Take the entire distribution from your IRA Rollover and pay ordinary income tax;
- Designate himself or herself as the IRA owner and begin taking distributions based on his or her single life expectancy, when your spouse attains age 70½. For this option the spouse must be the sole beneficiary of the IRA;
- Leave the IRA Rollover in your name and delay distributions until the year you would have reached age 70½ and then commence distributions based on his or her single life expectancy; or
- Take a total distribution and roll it over into a new IRA in his or her name.

If the beneficiary is an individual but not your spouse, the options are limited to the following:

- Take a total distribution and pay ordinary income taxes (this may be done over a five-year period); or
- Begin distributions from your IRA by December 31 of the tax year after your death, for a period based on the beneficiary's life expectancy.

If you had begun receiving minimum distributions before your death, your distribution for the year of death must be made as if you were alive and using your age as of that year. If the beneficiary is not an individual but your estate or trust, all assets must be distributed within five years of your death if you die before minimum distributions begin, or your remaining life expectancy if you die after minimum distributions begin. An exception to this rule may be available for beneficiaries of certain trusts. Consult your tax advisor or estate planner for specific details.

All taxable distributions to the beneficiary are taxed as ordinary income (unless rolled over by a surviving spouse into an IRA) in the year received. Furthermore, there is no longer any Federal estate-tax exclusion for distributions from an IRA Rollover. While under current law there is no Federal estate tax in 2010, taxable estates with a value in excess of $1,000,000 will be subject to Federal estate tax in 2011 and later years. State estate tax or inheritance tax may also be imposed. However, if the marital deduction is available, a spouse who is a U.S. citizen can receive your IRA Rollover assets without any estate tax liability.

If you have multiple beneficiaries, your IRA is distributed after your death using the life expectancy of the oldest beneficiary. However, your beneficiaries may divide your IRA into separate accounts (one per beneficiary) and each use his or her own life expectancy for distributions from the separate account.

IRA distributions to your designated beneficiary or beneficiaries must commence no later than December 31 of the year following the year of your death. However, the beneficiaries whose lives will be used to calculate post-death distributions and whether the IRA will be split into separate accounts for the beneficiaries must be decided and reported to the IRA custodian no later than September 30 of the year following your year of death. Also, the trustee of your trust has until October 31 of the year following your year of death to provide certain information to the IRA custodian that will allow the IRA to be distributed to the trust over the life expectancy of a trust beneficiary.

Choosing the proper distribution option is an important decision that may have significant tax ramifications. It is important to seek the counsel of your tax advisors.

Portability

The assets in an IRA Rollover account may be subsequently transferred to another qualified employer's retirement plan, a 403(b) plan or a governmental 457(b) plan, if the new plan permits acceptance of such funds. After-tax or nondeductible contributions may be rolled over if the receiving plan separately accounts for such contributions.

Making Your Decision

The decision on whether to roll your distribution into an IRA or to pay taxes currently is a complicated one and must take into consideration your total financial tax picture. To reach an informed decision, you should carefully consider your alternatives and their tax implications and discuss the matter with your tax or legal advisors.

Remember, whatever your decision, you will have all or part of your distribution to invest. How you invest these assets may significantly affect the funds you have available in your retirement years.

Advantage of Paying Taxes Now

If you opt to pay taxes now, you may be eligible for special tax treatment that could significantly reduce the amount of tax to be paid on the distribution. After paying this tax, the remaining monies are yours to dispose of as you wish without the early withdrawal penalties and some investment restrictions that apply to IRAs. Remember, however, depending upon the investments you choose, all earnings, interest, dividends or gains could be subject to income taxation each year.

Advantages of an IRA Rollover

If you choose to establish an IRA Rollover account, you will have no current tax liability, and the Rollover amount and any earnings on that amount have the opportunity to grow tax-deferred until withdrawn. Depending upon investment performance and overall return, tax deferral can significantly increase the value of your Rollover account over a period of time.

The chart on page 6 illustrates the importance of tax deferral by comparing the options available to you when you receive a lump-sum distribution.

Of course, funds withdrawn from an IRA Rollover will be taxed as ordinary income when withdrawn. However, you often will be in a lower tax bracket when you ultimately begin to receive distributions from the IRA. Postponing tax liability, the possibility of being in a lower tax bracket at retirement, and the opportunity for tax-deferred growth are important advantages of the Rollover account.

Why Choose Morgan Stanley Smith Barney?

Your Financial Advisor has the support of a staff of retirement plan professionals and can give you valuable input concerning the options available to you. Ask your Morgan Stanley Smith Barney Financial Advisor for a "Morgan Stanley Smith Barney Rollover Review™" report at no cost or obligation. The analysis will provide you with an illustration of the taxable and IRA Rollover alternatives.

Whether you ultimately decide to roll your lump-sum distribution into an IRA or to pay your taxes now, your Morgan Stanley Smith Barney Financial Advisor can help you tailor an investment program that is suited to your needs and objectives.

For More Information

If you have any additional questions, your Morgan Stanley Smith Barney Financial Advisor will be happy to explain the IRA Rollover plan in further detail to you. He or she can provide you with the documents necessary to establish the type of IRA Rollover you choose.

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