FREQUENTLY ASKED QUESTIONS CONCERNING THE DEFERRED RETIREMENT OPTION PLAN ("DROP") FOR INDIANA STATE POLICE

* Note: This is being provided as a general explanation of the new DROP option which is available for eligible Indiana State Police officers. Every effort has been made to ensure that this information is correct. However, in the event that this information is inconsistent with the provisions in the Indiana State Police Department Pension Trust Agreement ("Pension Trust Agreement"), the Pension Trust Agreement will control.

GENERAL QUESTIONS CONCERNING THE DROP

(1) What does the phrase "DROP" stand for?

"DROP" is the acronym for a deferred retirement option plan. "DROP" is a generic term that means different things for different pension plans. Other states and other pension plans may have a DROP, but the DROP established in the Pension Trust Agreement has been designed specifically for the Indiana State Police. Consult the rest of this document for a more complete explanation of how the Indiana State Police's DROP may affect you.

(2) What is a DROP?

A DROP is simply an option. No employee is required to participate or elect benefits under the DROP. Entering the DROP allows you to simultaneously earn a salary and also accumulate a "nest-egg" payable in a lump sum and/or as a monthly benefit. If you meet the requirements for eligibility, this gives you another benefit option that you may choose.

Generally, a DROP allows an eligible employee to continue working while the employee is accumulating an amount equal to the benefits that could have been received if the employee had retired.

Your decision to participate in the DROP or elect DROP benefits is optional and should be based on your facts and circumstances and your family situation. Each employee's facts and circumstances and family situation are different. If you elect DROP benefits, there are tax consequences (as there are with all benefits) that you should consider. You should consult with financial or tax advisors whom you trust in order to determine whether taking a DROP benefit makes sense for you and your family, taking into account both tax consequences and your family's financial planning.

(3) Is the DROP a separate retirement plan?

No. The DROP is just a new benefit option within the existing Pension Trust Agreement.

PARTICIPATION IN THE DROP

(4) Who is eligible to participate in the DROP?

To participate in the DROP, an employee must, on the date the employee enters the DROP, be currently eligible to retire and immediately begin drawing unreduced retirement benefits. A member of the Pre-1987 Plan must have at least 20 years of service in order to enroll in DROP. A member of the 1987 Plan must have at least 25 years of service in order to enroll in DROP. An employee on disability status may not enter the DROP.

(5) How long can I participate in the DROP?

For a sworn police employee, the DROP participation period may extend for no more than the earliest of (1) 60 consecutive months, (2) completion of 34 years of service or (3) reaching 65 years of age.

(6) How do I begin participating in the DROP?

In order to begin participating in the DROP, you must file an election form before your DROP entry date. The Department will provide you with the form, and the form must be completed and filed with Department. The Department will also provide you with an informational worksheet with an estimate of what your DROP benefit would be, compared with what your retirement benefit would be if you did not enter the DROP but instead continued to work for that period of time.

(7) What information must I supply on the election form I file to begin participation in the DROP?

You must state on the form the date on which you will enter the DROP, which will be the date as of which your DROP benefit will be calculated (your "DROP benefit calculation date"), and the date on which you will retire and terminate participation in the DROP. Your election to enter the DROP and your election of a retirement date are irrevocable; however, you may elect to terminate employment and DROP participation and retire on a date which is earlier (but not later) than the retirement date you have elected.

(8) What happens if I become disabled while I am in the DROP?

If you become disabled while you are in the DROP, you will continue in the DROP until all authorized accrued leave is exhausted. You will then be retired, with your eventual monthly pension benefit calculated on any salary increases you received while you were in the DROP. Your DROP accrual will be paid when you terminate.

(9) What happens if I die while I am in the DROP?

If you die in the line of duty while you are in the DROP, your DROP accruals will stop at the date of death and will be paid pursuant to the terms of the Pension Trust Agreement, which provides that the DROP accumulation will be distributed to your surviving spouse, surviving dependent children, surviving dependent parents, or estate, in that order, within one (1) year after the date of the employee's death. The pension will be calculated as if the employee had terminated on the date of death, based on the years of service completed on the DROP entry date, and paid pursuant to the terms of the Pension Trust Agreement. The surviving spouse benefit is calculated on the basic pension that would have been payable (20 years for the Pre-1987 Plan, 25 years for the 1987 Plan). The dependent child benefit is calculated at 30% of the surviving spouse benefit.

If you die and your death is not in the line of duty, your DROP accruals will stop at the date of death and will be paid pursuant to the terms of the Pension Trust Agreement, which essentially provides that the DROP accumulation will be distributed to your surviving spouse, surviving dependent children, surviving dependent parents, or estate, in that order, within one (1) year after the date of the employee' death. The pension will be calculated as if the employee had terminated on the date of death, based on the years of service completed on the DROP entry date, and paid pursuant to the terms of the Pension Trust Agreement.

(10) What if I change my mind after entering the DROP? Can I retire earlier than or later than the retirement date I elected at the time I entered the DROP?

You may always terminate employment and retire prior to the end of the DROP period you originally elected. **However, in no event shall your retirement and DROP termination date be later than the date you originally elected. At the end of your DROP period, you must terminate employment and retire. Also, it is important to note that you may make only one DROP election in your lifetime.**

(11) Am I required to make contributions to the Pension Fund while I am in the DROP?

No. During the time that you are in DROP, you will not make contributions to the Pension Fund. Your pension contributions will actually stop at the end of the payroll period following your entry in the DROP. This will result in additional income to you during your participation in the DROP. For example, under the 2015 pay scale, a 1987 Plan Master Trooper would have an additional net income of $3,672.76 per year while in the DROP. Members of the Pre-1987 Plan would have an additional net income of $2,338.18 per year under the 2015 pay scale while in DROP.

(12) If I enter the DROP, am I guaranteed employment with the Department?

No. Your employment rights and status are not changed by participation in the DROP. You may quit your job or the Department may terminate you in the same manner as before your participation in the DROP.

(13) If I enter the DROP, does the mandatory retirement age still apply to me?

Yes, for sworn police employees, the applicability of any mandatory retirement age is not affected by your participation in the DROP.

(14) What happens to pension loans I may have while I am in DROP?

If you have an existing pension loan(s) when you enter DROP, you will continue with the payroll deducted loan repayments while active and the pension loan deducted repayments upon termination.

(15) What happens if I go on an unpaid leave of absence while I am in DROP?

If you go on a leave of absence without pay while in DROP, you will not continue to accrue the DROP benefit while you are on the unpaid leave of absence, and the unpaid leave of absence will not extend the original DROP period.

(16) What happens if I go on military leave while I am in DROP?

If you go on military leave while you are in the DROP, you will continue to accrue the DROP benefits while on military leave, but the military leave will not extend the original DROP period. (Note: An employee who had one or more unpaid military leaves prior to enrolling in DROP must have repaid the pension contributions as set forth in the Pension Trust Agreement prior to enrolling in DROP to be credited with the time for the unpaid military leave(s).)

(17) After completing the DROP period, how do I file for benefits?

Completing the DROP entry form is an irrevocable notice of your retirement date. You must still file for your retirement benefits separately with the Department. You should file for retirement benefits well in advance of your DROP retirement date in order to minimize any interruption between your final paycheck and the commencement of your retirement benefits.

RETIREMENT BENEFITS UNDER THE DROP

(18) When I retire after participation in the DROP, what options do I have concerning retirement benefits?

At the time you enter the DROP, your monthly DROP accrual benefit will be calculated. This monthly DROP accrual benefit will be the basic monthly retirement benefit, calculated under the Pension Trust Agreement as of the date you enter the DROP as if you had retired on that date. Your DROP accrual benefit will not be recalculated during the DROP period for any reason. There is no interest or earnings applied to the DROP benefit.

Upon retirement, you have the right to your accumulated DROP accruals paid as a lump sum payment, a rollover to another retirement plan or IRA to the extent allowed by law, an annuity, or a combination of these three (3) forms of payment.

In addition to your DROP benefit, at retirement you will begin to receive your monthly pension. At the end of the DROP period, your salary history while in the DROP will be reviewed, and any salary changes (promotions, matrix changes) will be included in a recalculation of the pension to be received as your monthly pension benefit after termination (if it would be included as part of your highest consecutive 36 months of compensation). However, you will not be credited with additional years of service for the amount of time you spent in the DROP.

See question and answer number 20 below for a discussion on the taxation of your benefits.

ANNUAL ADJUSTMENTS TO MONTHLY RETIREMENT BENEFITS

(19) What happens if there is a salary adjustment while I am in DROP?

You will receive any applicable salary adjustments while you are working. However, your DROP accrual will not change while you are in the DROP. Once you begin receiving monthly benefits, your monthly benefit will be adjusted for any adjustments that would otherwise have applied to your monthly benefit. **For the Pre-87 Plan, the Department will take into account your total combined benefit, including your DROP benefit, however elected, in determining eligibility for any supplemental pension after your retirement.**

TAXATION OF BENEFITS UNDER THE DROP PLAN

The following is a discussion of some of the key tax issues you should consider with respect to the DROP benefit. However, you should consult with a tax or financial advisor so that you understand all of the tax consequences regarding the DROP benefit options and which option is best for you and your family. Additionally, please keep in mind that this discussion is based upon current tax law, and may be subject to change.

(20) When I retire, how will the lump sum or annuity DROP benefits be taxed?

At the conclusion of your DROP period you will be able to elect whether you want to receive your DROP benefits in (1) an eligible rollover, (2) a lump sum payment, (3) a monthly annuity, or (4) a combination of these three options.

Rollover. If you elect to have your lump sum DROP benefits rolled over to an eligible retirement plan or a traditional IRA (a "direct rollover"), there will be no taxes due on the amount of the rollover until you begin to withdraw these funds from the eligible retirement plan or IRA. At that point, your taxes will be based upon the amount withdrawn each year and the IRS requirements for the eligible retirement plan or IRA you selected.

Effective January 1, 2008, you may also elect to have your lump sum DROP benefits rolled over to a Roth IRA. That would result in taxes on the amount of a Roth IRA rollover.

Upon retirement, you will receive a detailed special tax notice prepared by the IRS describing your rights to make a direct rollover, and the types of eligible retirement plans or IRAs that can accept a direct rollover.

Lump Sum. If you elect to receive a lump-sum payment paid directly to you, the benefits will be taxed as ordinary income in the year you receive them, with a pro-rata recovery of tax basis (the amount of your post-tax employee contributions) under the applicable IRS regulations. You will not be able to recover all of your post-tax contributions with the lump sum payment. Additionally, if you do not make a direct rollover of these amounts, the Department is required to withhold 20% of the taxable amount of the lump sum for federal taxes when the lump sum is paid to you. You should carefully consider what taxes you will owe on the DROP benefits.

The following example shows how the basis recovery rules will work:

> An employee has pre-tax employee contributions totaling $40,000. The employee enters the DROP on January 1, 2016, and his monthly DROP accrual is $2,000. The employee retires December 31, 2020, with a total DROP accrual for 60 months of $120,000 and elects to take the entire $120,000 as a lump sum payment. The employee's monthly pension benefit is $2,100. Assuming that the employee chooses a single life annuity for the monthly pension benefit, the total value of the monthly pension benefit is $527,511; thus, the total value of the employee's DROP and monthly pension benefit is $647,511.
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> The employee will be able to recover a pro-rata share of the $40,000 of employee contributions tax-free from the lump sum payment as follows:
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> > $40,000 x $120,000/$647,511 (the total value of the benefit) = $7,413.

> Thus, the employee can recover $7,413 tax free from the lump sum payment, and the remaining $112,587 is taxable. Because 20% of the taxable amount of the lump sum payment must be withheld for income tax (in this example, $22,517.40 would be the tax withholding deduction), the actual payment the employee will receive is $97,482.60. The actual tax due on that amount will depend on the employee's total family taxable income, deductions and exemptions for the year the lump sum is paid.
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> NOTE: For simplicity, this example does not incorporate the special recovery rules for employee contributions made before January 1, 1987.

NOTE: If (i) you are under age 50[1] at the time you actually retire, and (ii) you elect a lump sum from the DROP to be paid directly to you, a 10% federal "early distribution" penalty tax may be assessed. Certain exceptions apply to this penalty and you should consult with your tax or financial advisor to determine if you personally may qualify for any exclusions if you are considering retiring before you have reached age 50 and electing a lump sum benefit under the DROP.

NOTE: Effective February 23, 2005, the Department implemented the "pick-up" of mandatory employee contributions to the Pension Trust, resulting in those contributions being made on a pre-tax instead of post-tax basis. Because your contributions were previously taxed when they were paid to the Pension Trust, you were able to recover a portion of those already taxed contributions ("basis") from your pension benefit, making a portion of your pension benefit non-taxable. Under the new "pick-up" program, your contributions are not taxed when paid to the Pension Trust, so these contributions will not be treated as "basis" when your pension benefit is paid at retirement (but you will recover any existing basis that you have under the Pension Trust).

Annuity. If you elect to take payment of your DROP benefit as a monthly annuity benefit, the DROP monthly payment will be taxed in the same manner as your monthly pension benefits. Part of your post-tax employee contributions will be recovered as tax basis when you begin to receive monthly benefits, in accordance with Internal Revenue Service regulations. Monthly annuity payments are not eligible for direct rollover.

If I have any additional questions, whom should I contact?

You should contact the DROP Administrator in Human Resources.

[1] Before the passage of the Pension Protection Act of 2006, this was age 55.