

Tax Information for TSP Participants Receiving Monthly Payments

Monthly payments are subject to Federal income taxes. The tax rules that applied at the time you chose your monthly payments remain in effect until you make a transaction that changes your payments. This notice explains how certain changes affect how your payment(s) are taxed. The chart on page 2 summarizes the rules that apply to each payment type. The tax rules are determined by the IRS category to which your payments belong. The TSP cannot give tax advice; we are providing this tax information to let you know that monthly payment changes may have tax consequences. You may also want to refer to the tax notice "Important Tax Information About Payments From Your TSP Account."

The TSP does not withhold for state or local income tax. However, we report all TSP distributions on IRS Form 1099-R to your state of residence if it has an income tax. Because tax rules are complex, you may wish to speak with a tax advisor or with state or local tax officials.

Changing to a final single payment

You can request your remaining account balance at any time. (See Form TSP-73 for civilians, TSP-U-73 for members of the uniformed services, or TSP-73-B¹ for beneficiary participants.²) Because final single payments are categorized as "eligible rollover distributions" for Federal income tax purposes, the IRS requires the TSP to withhold a mandatory 20% for Federal income taxes on all taxable portions of your payment. You cannot waive this withholding. However, the TSP will not withhold taxes on amounts that are transferred directly to a traditional individual retirement account (IRA), an eligible employer plan, or a Roth IRA.³ If your payment is sent directly to you, 20% will be withheld. You will have 60 days to roll over all or part of the payment into a traditional IRA, eligible employer plan, or Roth IRA.

If you elect to transfer or roll over all or part of the traditional (tax-deferred) portion of your payment into a **traditional IRA or eligible employer plan**, tax on that amount will be deferred until you withdraw the money from the IRA or plan. Alternatively, if you are eligible and elect to transfer or roll over the traditional portion of your payment into a **Roth IRA**, you will have to pay tax for the year of the transfer because a Roth IRA only accepts after-tax dollars. You will also have to pay tax on any amounts not transferred or rolled over in the current year.

If you elect to transfer or roll over all or part of any Roth portion of your final payment to a Roth IRA or a Roth account maintained by an eligible employer plan, you will not owe taxes on your contributions (because they have already been taxed), and you will defer taxes on your Roth earnings that are not yet qualified.⁴

¹ Forms TSP-73, U-73, and 73-B will be obsolete beginning in the fall of 2012, and replaced by Forms TSP-73, 78, and 79. All participants will be eligible to use these forms. (The forms will contain a tax withholding section, and Form W-4P will no longer be necessary.) Form TSP-73, Change in Monthly Payment Amount, will be used ONLY to make the annual change in payment amount. It will be mailed in the fall to participants who are receiving monthly payments, and will be due by December 15. Form TSP-78, Monthly Payment Maintenance, will be used to make changes in your direct deposit, tax withholding, or transfer information. Form TSP-79, Change From Monthly Payments to Final Payment, will be used to request a final single payment from your account.

² A beneficiary participant is a spouse beneficiary of a deceased civilian or uniformed services TSP participant for whom the TSP has established an account.

³ A **traditional IRA**, which accepts pre-tax dollars, is any IRA that is not a Roth IRA, a SIMPLE IRA, or an education IRA. An **eligible employer plan** includes a plan qualified under section 401(a) of the Internal Revenue Code, such as a section 401(k) plan, profit-sharing plan, defined benefit plan, stock bonus plan, and money purchase plan; a section 403(a) annuity plan; a section 403(b) tax-sheltered annuity; and a section 457(b) plan maintained by a governmental employer. A **Roth IRA** accepts only after-tax dollars, but provides tax-free earnings.

⁴ Earnings on your Roth contributions become "qualified," and are therefore paid tax-free, when 5 years have passed since January 1 of the calendar year you made your first Roth TSP contribution AND you are at least age 59½ or permanently disabled. If you transferred money to your TSP account from a Roth account maintained by an eligible employer plan, the 5-year clock begins on January 1 of the calendar year of the first Roth contribution you made—**either** to your TSP account or to the Roth account of the other employer plan.



Tax Notice

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Money the TSP withholds for taxes may or may not be enough to cover your tax liability. To have additional tax withheld, complete IRS Form W-4P and submit it with your Form TSP-73, TSP-U-73, or TSP-73-B.

Changing your monthly payments

Once a year, you have the opportunity to change your monthly payments. You can request a different dollar amount, or you can make a one-time-only change from TSP-computed payments to a specified dollar amount. (See Form TSP-73 for civilians, TSP-U-73 for members of the uniformed services, or TSP-73-B for beneficiary participants.)¹

IRS rules for withholding and for transferring or rolling over your payments to avoid withholding will depend on how the IRS categorizes your new monthly payments. The category will depend upon the number of monthly payments you will receive **after** your change goes into effect, and whether the payments are taxable, tax-free, or a combination of the two. (To estimate the number of monthly payments you will receive after your change goes into effect, divide your projected year-end account balance by the monthly dollar amount you will receive after the change.)

If you will be receiving fewer than 120 payments, the IRS will categorize your monthly payments as eligible rollover distributions. For Federal income tax purposes, the IRS will treat them the same way it treats a final single payment. Alternatively, **if you will be receiving 120 payments or more**,

the IRS will categorize your payments as “periodic payments.” You cannot transfer or roll over periodic payments into an IRA or an eligible employer plan, and withholding for periodic payments will be based on IRS withholding requirements for a person who is married with three dependents. Use IRS Form W-4P to increase, decrease, or waive the withholding for your periodic payments.

Transferring money into your account

If you are a civilian or uniformed services TSP participant and you are receiving monthly payments, you can transfer or roll over traditional (tax-deferred) money into your TSP account from an IRA or other eligible employer plan using Form TSP-60, Request for a Transfer Into the TSP. You can also transfer Roth money into your account from a Roth account maintained by an eligible employer plan using Form TSP-60-R, Request for a Roth Transfer Into the TSP. (You **cannot** transfer money into your account from a Roth IRA.) In these cases, the TSP recalculates the duration of your monthly payments beginning with your first payment the year following the transfer. If you are receiving payments:

- **Of a specific dollar amount**, the recalculation will occur only if you transferred \$1,000 or more, and only the duration of your payments will be affected. As a result, your tax withholding and eligibility to transfer all or part of your monthly payments to an IRA or eligible employer plan may also change (see the chart below).

Type of payment	Category for IRS purposes	Eligible for transfer or rollover?	Withholding rate	Can you increase withholding?	Can you decrease withholding?	Can you waive withholding?
Final single payment	Eligible rollover distribution	Yes	20% mandatory	Yes—complete line 3 of IRS Form W-4P ⁵	No	No
Monthly dollar amount paid out over less than 120 months ⁶	Eligible rollover distribution	Yes	20% mandatory	Yes—complete line 3 of IRS Form W-4P ⁵	No	No
Monthly dollar amount paid out over 120 months or more ⁷	Periodic payment	No	Based on married with 3 dependents	Yes—complete line 2 of IRS Form W-4P ⁵ to change exemptions and line 3 for additional dollar amount	Yes—complete line 2 of IRS Form W-4P ⁵	Yes—complete line 1 of IRS Form W-4P ⁵
Required minimum distribution ⁸	Non-periodic payment	No	10%	Yes—complete line 3 of IRS Form W-4P ⁵	No	Yes—complete line 1 of IRS Form W-4P ⁵

⁵ IRS Form W-4P is available from the TSP website and from the IRS.

⁶ If the payment is satisfying the IRS required minimum distribution amount, see the “Required minimum distribution” section of this chart.

⁷ Payments are treated as periodic even if they are satisfying the IRS required minimum distribution amount.

⁸ Required minimum distributions are **not** treated as non-periodic payments (for IRS purposes) if they are part of monthly payments that are expected to be paid over 120 months or more, or are part of monthly payments that are based on the IRS life expectancy table. In these cases, taxes are based on withholding for a married person with 3 dependents, under the IRS withholding rules for periodic payments.

- **Based on life expectancy**, the recalculation should increase the amount of each payment.

If you are a beneficiary participant, you may not transfer or roll over money into your TSP beneficiary participant account from an IRA or other eligible employer plan.

Early withdrawal tax penalty

If you are a civilian or uniformed services TSP participant who separated from service before the year you turned age 55 and are changing your payments based on life expectancy to monthly payments based on a fixed dollar amount or to a final single payment, you may be liable for the 10% early withdrawal penalty tax on the payments you previously received, if you make the change within 5 years of beginning your payments or before you are age 59 ½. To learn more, see IRS Publication 575, *Pension and Annuity Income*.

Beneficiary participants are not subject to the early withdrawal penalty tax.

Receiving required minimum distributions through your monthly payments

If you are a civilian or uniformed services TSP participant who is age 70½ or older and receiving monthly payments, the Internal Revenue Code requires that you receive a required minimum distribution (RMD) from your TSP account each tax year. Depending upon how much money you are required to receive, all or part of your monthly payments will be applied to that RMD. RMD payments, regardless of withholding, are not eligible to be transferred to an IRA or an eligible employer plan. See the TSP tax notice “Important Tax Information About Your TSP Withdrawal and Required Minimum Distributions.”

Beneficiary participants are subject to a different set of RMD rules. See the TSP tax notice “Tax Information About TSP Withdrawals and Required Minimum Distributions for Beneficiary Participants.”

Special note to former members of the uniformed services

TSP accounts for members of the uniformed services may include contributions from pay that is subject to the combat zone tax exclusion. That pay is exempt from Federal income tax. Monthly payments that include traditional (non-Roth) contributions from that pay may be transferred or rolled over into a traditional IRA or a Roth IRA or transferred to certain eligible employer plans, but **only if** the IRA or plan certifies that it will accept tax-exempt money.

Resources

You can obtain TSP forms and tax notices from the TSP website, www.tsp.gov, or by calling the TSP toll free at 1-877-968-3778 (TDD: 1-877-847-4385). Outside the U.S. and Canada, please call 404-233-4400 (not toll free). You can also fax a written request to 1-866-817-5023 or write to the TSP at the address on the TSP website. For IRS publications, see the IRS website, www.irs.gov, or call 1-800-TAX-FORM.