

# Tax Treatment of Thrift Savings Plan Payments Made Under Qualifying Orders

Qualifying orders are retirement benefits court orders, legal processes (including child support orders, IRS tax levies, and restitution orders), and child abuse orders that meet requirements set forth in 5 C.F.R. Part 1653.<sup>1</sup> Before you receive a payment made under a qualifying order from the Thrift Savings Plan (TSP), you should review the important information in this notice. Although the TSP can assist you in receiving your payment, we cannot provide tax advice. Because tax rules are complex, you may wish to speak with a tax advisor before you make any decisions that might have tax consequences.

## 1. General Tax Information

The tax treatment of a payment made under a qualifying order depends on the type of money contributed to the TSP account. A TSP account may consist of a traditional (non-Roth) balance, a Roth balance, or both.

Contributions to a **traditional (non-Roth) balance** are made pre-tax. This means the participant did not pay taxes on his or her own contributions, any agency contributions, or earnings. Therefore, taxes will be owed on the traditional (non-Roth) portion of a payment made under a qualifying order.

Contributions to a **Roth balance** are made after-tax. This means that the participant paid tax on his or her contributions before those contributions were made. Any amount of a payment that is made up of Roth contributions is not taxable. In addition, no taxes will be owed on the Roth earnings portion of a payment, provided certain Internal Revenue Service (IRS) rules are met.<sup>2</sup>

<sup>1</sup> **Retirement benefits court orders** are issued pursuant to court action for a divorce, annulment, or legal separation. They award an amount to be paid from a participant's (or beneficiary participant's) TSP account to a current (including separated) spouse or former spouse or a dependent. This includes alimony and property settlement awards. **Legal processes** are issued pursuant to state law and garnish a participant's account to enforce a current child support or alimony obligation. They may also be issued for the enforcement of IRS tax levies, or restitution orders pursuant to the Mandatory Victims Restitution Act (MVRA). **Child abuse orders** are issued to garnish a participant's account to satisfy a judgment related to the abuse of a child.

<sup>2</sup> The tax treatment of Roth earnings depends on whether those earnings are qualified. Earnings become qualified, and therefore paid tax-free, when **two** conditions are met: 1) 5 years have passed since January 1 of the calendar year in which the first Roth contribution was made **and** 2) the participant has reached age 59½, has a permanent disability, or has died. The TSP cannot certify to the IRS that you meet the Internal Revenue Code's definition of a disability.

Court orders, legal processes, and child abuse orders that designate a specific balance (traditional, Roth, or tax-exempt) from which payment should be made are not qualifying and will not be processed. Payments made under qualifying orders will be disbursed pro rata (i.e., proportionally) from any traditional (non-Roth) and Roth balances in the participant's TSP account.

The taxable portion of any payment made to a current or former spouse is taxable income to that individual. The taxable portion of any payment made to someone else (such as to a child for child support) is taxable income to the TSP participant (or beneficiary participant). The TSP will use the participant's age (or date of death if the payment is being made posthumously) and the date of the participant's first Roth contribution to determine whether the earnings in the participant's Roth balance are qualified, and therefore, will not result in taxable income to either the recipient or the participant.

## 2. Income Tax Withholding and Reporting

The TSP must withhold for federal income tax from taxable payments we make unless the person responsible for paying taxes is allowed to request that there be no withholding. The federal income tax withholding and rollover rules that apply to a payment made under a qualifying order are determined based on the recipient of the payment.

The chart on page 2 describes these rules; it also shows the withholding rate and whether the taxpayer can change or waive the withholding amount. If the taxpayer wants to change the standard withholding, he or she must file IRS Form W-4P, Withholding Certificate



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for Pension or Annuity Payments, with the TSP before the payment is disbursed.

The TSP reports all distributions to the Internal Revenue Service, and to the person responsible for paying taxes, on IRS Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.

The TSP **does not withhold for state or local income tax**. However, on IRS Form 1099-R, we do report all TSP distributions to the taxpayer's state of residence at the time of the payment (if that state has an income tax). The taxpayer may need to pay state and local income tax on the payment. Your tax advisor or state or local tax officials can explain any potential tax obligations.

### 3. Payments to State Child Support Enforcement Agencies, the Internal Revenue Service and MVRA<sup>3</sup> Garnishments

Special rules apply to payments made to state child support enforcement agencies, to the IRS as a result of a tax levy, and to a clerk of the court pursuant to MVRA garnishments. **These payments cannot be transferred or rolled over.** Therefore, the rules discussed in Section 5 of this tax notice do **not** apply to them. Additionally, the taxable portion of payments made to a state child support enforcement agency, to the IRS as a result of a tax levy, or to a clerk of

<sup>3</sup> Mandatory Victims Restitution Act

the court pursuant to an MVRA garnishment will be taxable to the participant for the year of the payment and is subject to federal income tax withholding. This withholding cannot be waived, increased, or decreased. (See the chart below for withholding rates.)

### 4. Beneficiary Participant Accounts

Special rules apply to qualifying orders processed against beneficiary participant accounts. Payments made from a beneficiary participant account pursuant to a qualifying order cannot be transferred or rolled over. Therefore, the rules discussed in Section 5 of this tax notice do **not** apply to payments from beneficiary participant accounts pursuant to qualifying orders.

### 5. Transferring or Rolling Over a TSP Payment Made Under a Qualifying Order

Payments made to a state child support enforcement agency, to the IRS as a result of a tax levy, or to a clerk of the court pursuant to an MVRA garnishment cannot be transferred or rolled over.

If you are the current or former spouse of a TSP participant (and your payment is **not** coming from a beneficiary participant account), you may be able to ask the TSP to transfer all or a portion of other court-ordered payments to a traditional individual retirement account (IRA), eligible employer plan, Roth IRA, or your own TSP account, if you have one. If you receive the payment directly, you may be able to deposit

#### Tax Treatment of TSP Payments Made Under Qualifying Orders<sup>1</sup>

Type of TSP Payment	Type of Payment for IRS Purposes	May the Recipient Transfer or Roll Over the Payment?	What Is the Withholding Rate?	May the Taxpayer Increase Withholding?	May the Taxpayer Decrease Withholding?	May the Taxpayer Waive Withholding?
<b>Court-ordered payment to a current or former spouse<sup>2</sup></b>	Eligible rollover distribution	Yes <sup>3</sup>	20% (unless transferred)	Yes — complete the withholding section of your payment method election form	No	No
<b>Court-ordered payment to a child or dependent</b>	Non-periodic payment	No	10%	No	No	No
<b>Payment to a state child support enforcement agency</b>	Non-periodic payment	No	10%	No	No	No
<b>Payment from a beneficiary participant account to a current or former spouse</b>	Non-periodic payment	No	10%	Yes — complete line 3 of IRS Form W-4P. <sup>4</sup>	No	Yes — complete line 1 of IRS Form W-4P. <sup>4</sup>
<b>Payment to the IRS for tax levy</b>	Eligible rollover distribution	No	20%	No	No	No
<b>Payment to a clerk of the court for MVRA garnishment</b>	Eligible rollover distribution	No	20%	No	No	No

<sup>1</sup> Withholding only applies to the taxable portion of the payment (e.g., the earnings portion of a nonqualified Roth distribution.)

<sup>2</sup> Applies to payments of \$200 or more received in a single year. For purposes of court orders, this does not apply to current or former spouses of beneficiary participants.

<sup>3</sup> You can transfer or roll over a payment into a traditional IRA, eligible employer plan, or Roth IRA.

<sup>4</sup> If you are receiving court-ordered payments from more than one TSP account, you must submit a separate IRS Form W-4P for each account.

(roll over) the payment into your traditional IRA, eligible employer plan, Roth IRA, or TSP account yourself.

Be aware that the tax rules regarding transfers and roll-overs can be complicated. You should consult a qualified tax advisor to ensure that you understand the tax consequences of such a transaction. If you are eligible, the necessary forms will be included with your decision letter.

A **traditional IRA** is any IRA that is **not** a Roth IRA, a SIMPLE IRA, or an education IRA. Before-tax money that is transferred from the TSP to a traditional IRA is not subject to tax until it is withdrawn from the 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; a section 457(b) plan maintained by a governmental employer; and the TSP. Certain eligible employer plans also accept money designated as Roth.

A **Roth IRA** accepts only after-tax dollars, but provides tax-free growth. If you transfer the traditional (non-Roth) portion of your payment to a Roth IRA, you must pay taxes on the funds for the year of the transfer. (**Note:** If the transfer includes tax-exempt money, these funds are not subject to tax.)

No IRA or eligible employer plan is required to accept a transfer or rollover. Before you decide to transfer or roll over a court-ordered payment, you should find out whether the IRA or plan accepts transfers or rollovers, the minimum amount it will accept, and whether tax-exempt contributions or Roth contributions, if applicable, will be accepted.

#### **A. Your Transfer and Rollover Options for Payments From a Traditional (non-Roth) TSP Balance**

As a current or former spouse of a TSP participant, you may transfer or roll over the traditional (non-Roth) portion of your court-ordered payment to a traditional IRA, an eligible employer plan, or a Roth IRA.

Keep in mind that the plan you choose to transfer or roll your funds into may be subject to different tax treatment plan rules than the TSP.

**If you choose to have the TSP transfer part or all of the traditional (non-Roth) portion of your court-ordered payment,** the TSP will make the payment directly to your traditional IRA, eligible employer plan, or Roth IRA. Also, the following rules apply:

- The transfer of the traditional (non-Roth) portion of your payment to a traditional IRA or eligible employer plan will not be taxed in the current year, and no income tax will be withheld. Your payment will be taxed when you withdraw it from the traditional IRA or the eligible employer plan.
- The entire transfer of the traditional (non-Roth) portion of your payment to a Roth IRA will be taxed in the current year. No income tax will be withheld at the time of the transfer. However, you may need to pay estimated taxes to mitigate your tax liability.

**If the TSP pays a court-ordered payment directly to you,** and you decide to do a **rollover** to a traditional IRA, Roth IRA, or eligible employer plan yourself:

- You will have up to 60 days after you receive the payment to make the deposit into your IRA or plan to avoid tax on the amount you roll over.
- The TSP is required to withhold 20% of your payment for federal income taxes. This means that in order to roll over your entire payment, you must use other funds to make up for the 20% withheld.
- If you do not roll over the entire amount of your payment, the portion not rolled over will be taxed.

If you roll over a payment from a traditional (non-Roth) balance to a Roth IRA, you must pay income tax on the taxable amount rolled over; the tax is due for the year of the rollover.

#### **B. Your Transfer and Rollover Options for Payments From a Roth Balance**

As a current or former spouse of a TSP participant, you may transfer or roll over the Roth portion of your court-ordered payment to a Roth IRA or a Roth account maintained by an eligible employer plan that will accept the rollover. Keep in mind that the rules of the Roth IRA or eligible employer plan that receives the rollover will determine your investment options, fees, and rights to payment from the Roth IRA or eligible employer plan. Further, the amount rolled over will become subject to the tax rules that apply to the Roth IRA or the Roth account maintained by the eligible employer plan. In general, these tax rules are similar to those described elsewhere in this notice, but differences include:

**If you choose to have the TSP transfer part or all of the Roth portion of your court-ordered**

**payment**, the TSP will make the payment directly to your Roth IRA or Roth account maintained by an eligible employer plan.

- The transfer of the Roth portion of your payment to a Roth IRA or a Roth account maintained by an eligible employer plan will not be taxed in the current year and no income tax will be withheld. However, your payment from that plan may be taxed when you withdraw it. If, at that time, your payment does not meet the IRS rules for qualified earnings (see Section 1 of this tax notice), the taxable portion will be subject to federal tax withholding.
- If you choose to have the TSP transfer only a portion of your payment and a portion is paid to you, the taxable portion will be transferred first. Nontaxable money will be transferred only if the taxable portion of the withdrawal does not satisfy the participant's transfer election.

**If the TSP pays an eligible rollover distribution directly to you**, and you decide to do a **rollover** to a Roth IRA or Roth account maintained by an eligible employer plan yourself:

- You will have up to 60 days after you receive the payment to make the deposit into your Roth IRA or Roth account maintained by an eligible employer plan.
- If your payment is not a qualified Roth distribution, the TSP is required to withhold 20% of the earnings for federal income taxes. This means that in order to roll over your entire payment to a Roth IRA, you must use other funds to make up for the 20% withheld.
- You can only roll over your payment into a Roth account maintained by an eligible employer plan if the payment is nonqualified (taxable) and the rollover amount does not exceed the amount of the earnings in the payment.
- You cannot do a 60-day rollover to an eligible employer plan of any part of a qualified distribution.
- If you receive a nonqualified distribution and you do not roll over an amount at least equal to the amount of the earnings, you will be taxed on the amount of the earnings not rolled over.

## 6. Special Note Regarding Tax-Exempt Money

TSP accounts for members of the uniformed services and the beneficiary participant accounts that result from them may include contributions from pay that is subject to the combat zone exclusion. Those contributions

are tax-exempt and remain tax-exempt even when the money is paid under a qualifying order.

However, the earnings on tax-exempt contributions may or may not be taxable. Earnings on contributions made to a traditional (non-Roth) balance are taxable when they are distributed. But earnings on contributions made to a Roth balance are not taxable if they satisfy the IRS rules for qualified earnings (see Section 1 of this tax notice).

**Note:** Payments from traditional balances that contain both taxable and tax-exempt money will be paid proportionally from taxable and tax-exempt amounts.

If a payment is eligible to be transferred, any TSP tax-exempt contributions may also be transferred or rolled over to an IRA or eligible employer plan if the IRA or plan certifies that it will accept tax-exempt contributions. If the IRA or plan does not accept tax-exempt money, the tax-exempt funds will be paid directly to the recipient of the court-ordered payment.

Tax-exempt balances from a court-ordered payment may not be transferred into a spouse's or former spouse's TSP account if he or she has one.

## 7. Ten-Year Tax Option

If you are the spouse or former spouse of a participant who was born before January 2, 1936, you may be eligible to calculate the amount of the tax on the court-ordered payment by using the 10-year tax option, which will often reduce the tax you owe. To learn more, see IRS Publication 575, *Pension and Annuity Income*, and IRS Form 4972, *Tax on Lump Sum Distributions*. The 10-year tax option does not apply to court-ordered payments made from beneficiary participant accounts.

## 8. Rules for Nonresident Aliens

Special tax withholding rules apply to payments the TSP makes to nonresident aliens. To learn more, see the TSP tax notice "Special Tax Withholding Rules for Thrift Savings Plan Payments to Nonresident Aliens."

## 9. Resources

TSP publications are available from the TSP website, [www.tsp.gov](http://www.tsp.gov), or from the TSP by calling 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 send a fax to 1-866-817-5023 or write to the TSP at the address on the website.

IRS publications are available from your local IRS office, on the IRS website at [www.irs.gov](http://www.irs.gov), or by calling 1-800-TAX-FORM.