

Government Executive

TSP Tax Tips

By Tammy Flanagan

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As you probably are well aware, the federal Thrift Savings Plan is about retirement savings. But it's also about taxes. The money you put away in the TSP for your retirement years gets preferable tax treatment to provide you with a greater incentive to save now for your retirement later.

You have the option to save pre-tax dollars and allow your savings to grow tax-deferred. You can also, with the Roth option, choose to save after-tax dollars now, allowing the money to grow tax-free. That way, in your retirement years, the withdrawals will not be subject to income tax.

If you have retired and are beginning to consider your TSP withdrawal options, you also need to consider the tax consequences of your choices. The TSP offers [variety of publications](#) and a [Retirement Income Calculator](#) to help you decide which course of action is best for your situation.

Besides ordinary income taxes, your TSP funds can be subject to tax penalties for taking your money out too early—or not taking it out early enough.

According to this [TSP fact sheet](#), if you receive a TSP distribution before you reach age 59½, in addition to regular federal income tax, you may have to pay an early withdrawal penalty equal to 10 percent of any taxable portion of the distribution not transferred or rolled over. The 10 percent penalty, the TSP says, generally does not apply to payments that are:

- Paid after you separate from service during or after the year you reach age 55 (or the year you reach age 50 if you are a public safety employee).
- Annuity payments.
- Automatic enrollment refunds.
- Made as a result of total and permanent disability.
- Made because of death.
- Made from a beneficiary participant account.
- Made in a year you have deductible medical expenses that exceed 10 percent of your adjusted gross income (7.5 percent if you or your spouse is 65 or over).
- Ordered by a domestic relations court.
- Paid as substantially equal payments over your life expectancy.

Last year, Congress changed the withdrawal penalty rules for a certain group of federal employees. Under the Defending Public Safety Employees' Retirement Act, federal law enforcement officers, customs and border protection officers, firefighters, and air traffic controllers who separate from service in or after the year they turn 50 are allowed to make a withdrawal from the TSP [without incurring the 10 percent penalty](#). The law applies to TSP withdrawals paid after Dec. 31, 2015.

Another important tax rule to keep in mind is the penalty applied if you don't withdraw a minimum amount from your account by a certain time. That's right: You can be penalized for taking your money out too early, but also if you don't take it out soon enough.

There's a sweet spot between 59½ and 70½ when you can do almost anything you want, but after April of the year following the year you turn 70½ (and are separated from federal service), you face the dreaded [Required Minimum Distributions](#).

This can lead to some interesting consequences. Consider this story, courtesy of a longtime reader of this column:

They say that experience is the best teacher—not so when it requires burning your hand to find out the stove is hot, or it costs you money to discover that you needed an extra paper on file.

There were shocks when the TSP paid out my 2015 RMD by transferring the account balance in my account to my IRAs (traditional and Roth):

1. The TSP combined the RMD amount using the traditional and Roth sides of the account.
2. They did not issue separate checks or roll the funds, which precluded moving the TSP Roth funds to the Roth IRA.
3. The TSP did not provide for a greater than 10-year age difference between me and my spouse for RMD.

Then the real “gotcha” for 2016: When I asked to cash my RMD for this year, I needed more paperwork—authorization to do phone transactions, distribution request form on file, etc.—and my 2016 RMD will not consider the spousal age difference because there was not a beneficiary form naming my spouse on file as of Jan. 1, 2016. There is no “go-back” or later correction of the beneficiary (even though she would be the estate beneficiary) to capture the age difference for the 2016 RMD. This forces a higher RMD for 2016 than would otherwise be required.

Here’s the [TSP’s explanation of the rules about RMDs](#). I’ll let you decide if these instructions are clear and simple enough to avoid “gotcha” situations.

One last thing to keep in mind is that even though the TSP looks like an Individual Retirement Arrangement and sort of acts like an IRA, it’s not an IRA. The rules that apply to IRAs and even to 401(k) plans are not identical to the regulations that govern the TSP. And the nuances that make them different can put a monkey wrench in your withdrawal plans. Consulting a tax or financial planning professional who works with other federal clients before you make a move could help you avoid unanticipated consequences.

Photo: Flickr user [Ken Teegardin](#)

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<http://www.govexec.com/pay-benefits/retirement-planning/2016/02/tsp-tax-tips/125886/>