Government Executive

Don't Rush to Withdraw Your Retirement Savings

By Tammy Flanagan

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Last week President Obama signed into law a measure allowing federal law enforcement officers, Customs and Border Protection officers, firefighters and air traffic controllers to access funds in their Thrift Savings Plan accounts without penalty under certain circumstances when they retire early.

The Defending Public Safety Employees' Retirement Act ensures that such employees who retire in or after the year they turn 50 will not be subject to the 10 percent tax penalty on TSP retirement funds and other 401(k)-type plans tapped before the age of 59 and a half.

The TSP Board says it's reviewing the law and expects to publish information on its website about implementing it before the measure takes effect on Dec. 31.

It's possible that other groups of employees with early retirement eligibility, such as Foreign Service Officers or employees of the Central Intelligence Agency, may also one day get penalty-free access to their TSP funds. But that would take another act of Congress.

Also, there are other exceptions to the 10 percent penalty. You can find a complete list on page 7 of the TSP publication, *Important Tax Information about Payments from Your TSP Account*.

If you are among those who have the opportunity to access your retirement savings without tax penalty, you now face a question: Should you?

Here are some reasons why you might not want to rush to tap your TSP even if you can:

You may not need the money. If you plan to go back to work after you retire, you probably won't need to begin using your retirement savings. Many employees who retire under special provisions between the ages of 50 and 55 are not able to fully retire because they are not financially ready or they are not ready to retire mentally at such a young age. If your plan is to go back to work on Monday after you retired on Friday, then you may benefit from allowing your retirement savings to continue to grow.

Remember the rule of 72: divide the rate of return into 72 to see how fast your money will double. For example, if your investment earns a 6 percent rate of return, your money will double in 12 years. That means that if you have $250,000 in the TSP at age 50, it could be worth $500,000 when you're 62.

You still have to pay income tax on traditional TSP withdrawals. Some employees may decide to take advantage of the new law to withdraw a large lump sum to pay off their mortgage or reduce other outstanding debt. Remember, though, that even if you're not subject to the 10 percent early withdrawal penalty, you still have to pay federal and, in most cases, state income taxes on your TSP withdrawal. A large lump sum withdrawal will require you to pay the highest marginal tax rate on this money.

You may lose a tax write-off. Also, remember that if you have a mortgage, you can deduct the mortgage interest from your taxes. So it might not be the best idea to pay off your mortgage.

You may have other money in a taxable account. If you've been saving for retirement using mutual funds or other investments outside of the TSP or Individual Retirement Arrangements, then you may wish to draw on this money before tapping your tax-deferred funds. Even if you need to pay capital gains taxes on these withdrawals, the rate for most people is only 15 percent, not 28 percent or higher.

You might run out of money if you withdraw too much too soon. It's hard to predict exactly how long your funds will last. There's that whole life expectancy thing, and rates of return can make a big difference over the long haul. For example, if your TSP balance is $400,000 and it is earning, on average, a 4 percent return, then withdrawing $2,000 per month would mean that you'd be out of money by age 75. But change the return to 6 percent, and you'd still have a balance of more than $200,000 at age 95.

Of course, even given all the above considerations, it may be in your interest to tap your TSP investments as soon as you retire. After all, the money you have been saving in the TSP is for your retirement years. If you're able to retire as young as age 50, then you may need to use the TSP to supplement your Federal Employees Retirement System benefit and your FERS Supplement.

On July 20, the For Your Benefit show on Federal News Radio, hosted by Bob Leins and Tammy Flanagan, will cover the TSP tax changes for law enforcement officers, firefighters and air traffic controllers, along with other issues related to these special retirement groups. The program airs from 10 am to 11 am ET.

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