Important Tax Information About Payments From Your TSP Account

Except as noted below for uniformed services accounts, amounts paid to you from your Thrift Savings Plan (TSP) account are taxable income to you for Federal income tax purposes in the year in which payment is made. Depending on the withdrawal method you choose, different withholding rules apply. For example, there is **mandatory 20% Federal income tax withholding on certain payments** unless you ask the TSP to transfer them to a "traditional IRA" or an eligible employer plan.[1] To see how these tax rules apply to your TSP payment, **read this notice carefully.**

We are required by law to provide you with this notice; because the tax rules are complex, however, you may wish to consult a tax advisor before you make any decision that might be affected by them.

Special Note for Uniformed Services Accounts

TSP accounts for members of the uniformed services may include contributions from combat zone pay. Combat zone pay is exempt from Federal income taxes; therefore, TSP contributions from combat zone pay are also exempt from Federal income taxes when they are subsequently distributed from a TSP uniformed services account. (This is not true for the earnings attributable to contributions from combat zone pay; all earnings are taxable when they are distributed from a TSP account.)

The TSP will make all payments from a uniformed services account on a *pro rata* basis from both taxable and tax-exempt balances. A payment made from a uniformed services TSP account will therefore include taxable and tax-exempt balances if the account includes contributions from combat zone pay. Internal Revenue Service (IRS) Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., which the TSP provides you, will separately state the total amount of your distribution and the amount of your taxable distribution. (*See Section 3 of this notice.*)

[1] A "traditional IRA" is an individual retirement account described at § 408(a) of the Internal Revenue Code (I.R.C.) or an individual retirement annuity described at I.R.C. § 408(b). (It does not include a Roth IRA, a SIMPLE IRA, or a Coverdell Education Savings Account (formerly known as an education IRA).) An "eligible employer plan" includes a plan qualified under I.R.C. § 401(a), including a § 401(k) plan, profit-sharing plan, defined benefit plan, stock bonus plan, and money purchase plan; an I.R.C. § 403(a) annuity plan; an I.R.C. § 403(b) tax-sheltered annuity; and an eligible I.R.C. § 457(b) plan maintained by a governmental employer.

Unless otherwise noted, the following discussion regarding taxability and withholding applies only to the taxable portion of a payment.

1. Tax Withholding

TSP payments made directly to you are subject to Federal income tax withholding. For withholding purposes, there are three types of payments: **eligible rollover distributions**, **periodic payments**, and **non-periodic payments**. Federal income tax withholding rules are different for each type of payment, as described below. **The TSP does not withhold amounts for state or local income tax.**

Eligible Rollover Distributions

The following TSP payments are **eligible rollover distributions**:

- A single payment of all or part of your TSP account after you separate from service.
- A partial withdrawal payment.
- An age-based in-service withdrawal payment.
- An automatic cashout payment (i.e., payout of an account that is less than $200).
- Monthly payments when the payment amount you choose is expected to be paid out in less than 10 years (except payments computed by the TSP according to the IRS life expectancy table). (*See "Special Note About Monthly Payments" on page 3.*)
- A final single payment made after a series of monthly payments.
- Amounts paid directly to you after the complete withdrawal of your TSP account (e.g., late contributions).
- Death benefits paid to the surviving spouse of a deceased participant.
- Payments made to a current or former spouse of the participant pursuant to an order of a court in an action for divorce, annulment, or legal separation, or in response to an alimony or child support garnishment order.

The following tax withholding rules apply to eligible rollover distributions:

- The mandatory tax withholding on all eligible rollover distributions of $200 or more paid in a single year is 20%. The 20% is tax withholding, not actual tax due; therefore, when you file your annual Federal income tax return, you may be entitled to a refund of a portion of this amount, or you may be required to pay an additional amount.
- You can avoid withholding on all or any portion of an eligible rollover distribution by asking the TSP to transfer that amount to a traditional IRA or an eligible employer plan. However, you **cannot** avoid the mandatory 20% withholding on any amount that you elect to receive directly, including payments made by electronic funds transfer (EFT) to your personal checking or savings account, even if you then roll it over to a traditional IRA or an eligible employer plan. (*See Section 2 of this notice.*)
- You may elect to have an amount withheld in addition to the 20% withholding by completing Line 3 of IRS Form W-4P, Withholding Certificate for Pension or Annuity Payments.[2] You should submit this form to the TSP Service Office at the address provided at the end of this notice. Line 1 and Line 2 are not valid elections for this type of payment.
- There is no withholding on eligible rollover distributions that are less than $200. The $200 minimum amount applies to the total amount of all payments expected to be made in a single tax year. (For example, if you are receiving an eligible rollover distribution that is a series of monthly payments expected to last less than 10 years, the no-withholding rule will apply only if the total of the payments expected to be made in one tax year (the calendar year, for most taxpayers) is less than $200.) You can still elect withholding for any eligible rollover distribution of less than $200 by completing Line 3 of Form W-4P.

Periodic Payments

The following TSP payments are **periodic payments**:

- Monthly payments, if the payments are made for 10 years or more. (*See "Special Note About Monthly Payments" on page 3.*)
- Monthly payments computed according to the IRS life expectancy table. (*See "Special Note About Monthly Payments" on page 3.*)

[2] If you have both a civilian TSP account and a uniformed services TSP account, you must submit a separate IRS Form W-4P for each account.

Withholding for periodic payments will be based on the assumption that you are a married individual claiming three withholding allowances, unless the TSP Service Office receives from you IRS Form W-4P, Withholding Certificate for Pension or Annuity Payments. Withholding is calculated using IRS Publication 15, *Employer's Tax Guide,* or IRS Publication 15-A, *Employer's Supplemental Tax Guide*. The IRS annually updates the instructions to Form W-4P to show the minimum periodic payment amounts on which withholding is required.

If you submit IRS Form W-4P, you may elect:

- to have no Federal income tax withheld by completing Line 1 of Form W-4P; or
- to have Federal income tax withheld based on the allowances and marital status that you indicate on Line 2 of Form W-4P. Withholding will then be computed using the IRS publications referred to above; or
- to have an additional amount withheld by completing Line 3 of Form W-4P. The amount that you specify on Line 3 will be added to the amount that would otherwise be withheld, based on the assumption regarding withholding described previously, or based on the election you made on Line 2.

A withholding election submitted with a request for monthly payments will remain in effect until the TSP Service Office receives a new IRS Form W-4P from you. A new withholding election will be effective beginning with the first payment after the form is processed. You may change elections concerning your withholding as often as you wish. Additional copies of Form W-4P are available from your local IRS office or from the TSP Service Office.

Note: Payments you receive from an annuity that the TSP purchases for you are also periodic payments. After your annuity is purchased, you will receive information from the annuity provider about making a withholding election.

Non-Periodic Payments

The following TSP payments are **non-periodic payments**:

- Financial hardship in-service withdrawals.
- Minimum distribution payments, i.e., payments required to be made to a participant automatically when he or she is age 70½ or older and separated from Federal civilian service or the uniformed services. (*See the TSP tax notice Important Tax Information About Your TSP Withdrawal and Required Minimum Distributions.*)

- Death benefits paid to someone other than the spouse of the participant.
- Payments made to someone other than the current or former spouse of the participant pursuant to an order of a court in an action for divorce, annulment, or legal separation, or in response to an alimony or child support garnishment order.

The TSP will withhold 10% for Federal income tax from non-periodic payments unless the TSP Service Office receives IRS Form W-4P, Withholding Certificate for Pension or Annuity Payments, from you (or the payee).

If you submit IRS Form W-4P, you may elect:

- to have no Federal income tax withheld by completing Line 1 of Form W-4P; or
- to have an amount withheld in addition to the 10% by completing Line 3 of Form W-4P.

Line 2 of Form W-4P is not a valid election for this type of payment.

Special Note About Mixed Withdrawals

When you separate from Federal civilian service or the uniformed services, you will be eligible to receive your TSP account balance in any combination of the following: a single payment, monthly payments, and/or a life annuity. Depending upon how each method of payment is classified for Federal tax purposes (i.e., as an eligible rollover distribution, or as periodic or non-periodic payments), different rates of withholding may apply to each.

Note: You must submit a separate IRS Form W-4P, Withholding Certificate for Pension or Annuity Payments, for each part of a mixed withdrawal for which you can make a withholding election, if otherwise applicable. For example, if you elect to receive your TSP account balance as a combination of a single payment and monthly payments, and you wish to have an additional $100 in Federal income tax withheld from your single payment and an additional $100 a month withheld from your monthly payments, you must submit one Form W-4P for the single payment and a separate Form W-4P for the monthly payments in order to have the specified amounts withheld from each payment that you receive. You must write on the top of the Form W-4P the option (i.e., "monthly payment" or "single payment") to which the withholding should apply.

Special Note About Monthly Payments

Monthly payments can be either **eligible rollover distributions** or **periodic payments**. (However, if monthly payments are used to satisfy required minimum distributions, they are generally taxed at the non-periodic payment rate.)

Monthly payments expected to be made for less than 10 years are treated as **eligible rollover distributions**, and are subject to mandatory 20% withholding unless the total paid in one tax year is expected to be less than $200, or unless payments are transferred as explained in Section 2 of this notice.

Monthly payment amounts which result in payments expected to be made for 10 or more years or which are calculated based on life expectancy are subject to withholding under the **periodic payment** rules, as explained earlier.

Therefore, when choosing monthly payments, you must consider the category into which your payments will fall. The TSP will use the following rules in making this determination:

- **If you choose to have your payments based on life expectancy,** your payments will be treated as periodic, no matter how long they last. Payments are calculated based on IRS life expectancy tables.[3]
- **If you choose to receive payments of a certain dollar amount,** the TSP will divide your account balance at the time payments begin by the dollar amount you choose. If the result is 120 or more, your payments will be treated as periodic. If the result is less than 120, your payments will be treated as eligible rollover distributions.
- **If you change to a final single payment from a series of monthly payments,** that final payment will be treated as an eligible rollover distribution.

Note: Once a year, you will be permitted to make a change in the amount of your monthly payments. If you are receiving monthly payments based on the IRS life expectancy tables, you will also be able to change (irrevocably) to monthly payments based on a dollar amount. If you make either change, the tax withholding on your new payments will be determined according to whether the new payments are eligible rollover distributions or periodic payments. If you had Form W-4P on file relating to your previous election, you will need to submit a new one for your new payment amount.

Special Note for Nonresident Aliens and Beneficiaries of Nonresident Aliens

Special tax withholding rules apply to TSP payments made to nonresident aliens and beneficiaries of nonresident aliens. For a detailed explanation of how these

[3] The IRS Single Life Table, Treas. Reg. § 1.401(a)(9)-9, Q&A-1, is used to calculate monthly payments based on life expectancy for participants who are 69 years old or younger. Once a participant turns 70, the Uniform Lifetime Table, Treas. Reg. § 1.401(a)(9)-9, Q&A-2, is used.

rules apply to you, please read the TSP tax notice "Tax Treatment of Thrift Savings Plan Payments to Nonresident Aliens and Their Beneficiaries." You can obtain a copy of the notice from the TSP Web site (www.tsp.gov) or by calling or writing to the TSP Service Office.

A **nonresident alien** is an individual who is neither a citizen nor a resident of the United States.[4] A **resident alien** is a non-citizen who is or was a lawful permanent resident of the United States during any part of a calendar year. An alien may also be considered a U.S. resident if the individual meets the IRS "substantial presence" test for a calendar year.[5] For information on residency status and the tests for residency, you may obtain IRS Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities*, or IRS Publication 519, *U.S. Tax Guide for Aliens*.

Other Tax Withholding Information

You may request that there be no tax withholding from a periodic or a non-periodic payment. You can do so by completing Line 1 of IRS Form W-4P. If you submit Form W-4P with Line 1 completed and you subsequently decide you want tax withholding, you may revoke your prior decision by completing another Form W-4P and writing "Revoked" on Line 1 of the form. Taxes will then be withheld at the rate set by law.

If you do not have enough Federal income tax withheld from your payment, you may be responsible for paying estimated tax. You may also incur penalties under the IRS estimated tax rules if your withholding and estimated tax payments are not sufficient.

You can request additional withholding from a periodic or non-periodic payment or from an eligible rollover distribution. To do so for a periodic payment, complete Lines 2 and 3 of IRS Form W-4P. For a non-periodic payment or an eligible rollover distribution, complete Line 3.

If you complete Line 3 of IRS Form W-4P and the total amount of the withholding equals or exceeds the amount of your payment, your entire payment will be withheld.

The TSP does not withhold for state, city, county, or other local income tax. Therefore, you should consult your tax advisor or relevant state or local taxing authorities regarding any potential tax obligations to them.

[4] The "United States" includes the 50 States and the District of Columbia.

[5] This is commonly referred to as the "green card" test.

2. Transferring or Rolling Over Your TSP Payment

If your payment is an **eligible rollover distribution** as described in Section 1, all or any part of it can either be transferred or rolled over to a traditional IRA or an eligible employer plan. This permits you to postpone paying tax on that amount until you withdraw the money from the IRA or plan. However, distributions from the IRA or plan to which the transfer or rollover was made may be subject to different plan rules (such as spousal consent) and tax consequences from those that apply to distributions from the TSP. Before making the transfer, you should consult with the administrator of the IRA or plan that is to receive your distribution.

A **transfer** occurs when you instruct the TSP to send all or part of your payment directly to a traditional IRA or an eligible employer plan instead of issuing it directly to you. Mandatory 20% Federal income tax withholding does not apply to an amount that the TSP transfers directly to a traditional IRA or an eligible employer plan; **however, it does apply to any payment made directly to you (or to your personal checking or savings account via EFT), even if you then roll it over.**

A **rollover** occurs when the TSP makes a distribution to you (which includes the amount of the payment you receive plus the amount of tax withheld) and you deposit any part of that distribution into a traditional IRA or an eligible employer plan within 60 days of the date you receive it.

In deciding whether to choose a transfer or a rollover, you should consider the following:

- You must pay Federal income tax and, if applicable, the 10% early withdrawal penalty tax on any part of the payment that you do not transfer or roll over. (*See Section 4 of this notice.*)
- Because all eligible rollover distributions of $200 or more made directly to you (or to your personal checking or savings account via EFT) are subject to mandatory 20% withholding, you must pay Federal income tax on the amount withheld for taxes — even if you roll over the amount you receive — unless you deposit personal funds equal to the amount withheld into your traditional IRA or eligible employer plan. (If you do this, you may receive a refund of taxes withheld, but you cannot wait until you receive a refund of the withheld amount to complete a rollover.)

Therefore, if you do not want to use personal funds to make up the amount withheld, you should choose to have the TSP transfer your account to your traditional IRA or eligible employer plan directly, instead of rolling it over to your IRA or plan yourself.

If you choose to receive a series of monthly payments that is expected to last for less than 10 years, your decision whether to transfer all or any part of a payment will apply to all later payments in the series unless you change your election to have funds transferred, or unless you change your payment amount and your new monthly payments are no longer considered eligible rollover distributions. You are free to make this change later.

Amounts paid to you as a minimum distribution because you have reached age 70½ may not be transferred or rolled over.

Special Note for Uniformed Services Accounts

Tax-exempt balances (i.e., contributions from combat zone pay) may be transferred or rolled over into a traditional IRA or transferred into certain eligible employer plans, but only if the IRA or plan accepts tax-exempt balances. Although an eligible rollover distribution will be distributed to you based on the proportion of taxable and tax-exempt balances in your account, if you choose to transfer a portion of the distribution, the taxable balance will be transferred to your IRA or plan first. Tax-exempt money will be transferred only if the taxable portion of your distribution does not satisfy the percentage that you elect to transfer to your IRA or plan. Any tax-exempt money in your withdrawal that cannot be transferred will be paid directly to you (or to your checking or savings account, if you so elect).

You may only transfer (not roll over) a tax-exempt balance to an eligible employer plan. The only types of eligible employer plans that can accept a transfer of tax-exempt balances from the TSP are plans qualified under I.R.C. § 401(a) and I.R.C. § 403(a) annuity plans; however, a plan is not legally required to accept such a transfer.

You cannot first transfer or roll over a tax-exempt balance into a traditional IRA and later transfer or roll over that amount into an employer plan. If you transfer or roll over a tax-exempt balance into a traditional IRA, it is your responsibility to keep track of the amount of these contributions and report that amount to the IRS on the appropriate form so that the nontaxable amount of any future distribution(s) can be determined.

Tax-exempt balances in a uniformed services TSP account may not be transferred into a civilian TSP account.

3. Tax Reporting

The TSP will report to the IRS all payments that are made directly to you, as well as all transfers made to traditional IRAs or to eligible employer plans. The TSP will also report TSP payments and transfers to the state in which your TSP account record shows you resided (or, for members of the uniformed services, your state of legal residence as reported by your payroll office) at the time the payments were made, if that state has an income tax.

Annuity purchases are not reported by the TSP to the IRS or to your state of residence. Payments made under an annuity that the TSP purchased for you will be reported for tax purposes by the annuity provider.

In January of the year that follows your TSP payment, the TSP will send you Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. You should include the taxable amount reported on Form 1099-R as income on your individual income tax return for the year in which payment was made. **You should keep the TSP informed of any changes in your address until this tax information is sent to you; if you are still employed, do so through your agency or service; if you are separated, advise the TSP Service Office directly.**

4. Early Withdrawal Penalty Tax

In addition to the ordinary income tax that you pay on TSP payments, in certain situations you must also pay an early withdrawal penalty tax of 10% on the amount that you receive directly from the TSP (including any tax withholding), unless such payments are transferred or rolled over.

If you separate from civilian Federal service or the uniformed services before the year in which you reach age 55, the penalty tax will apply to all amounts that you receive before you become age 59½ (including a taxable loan distribution, if any). However, the early withdrawal penalty tax does not apply to the following payments:

- Annuity payments or payments made because of death.
- Amounts paid pursuant to an order of a court in an action for divorce, annulment, or legal separation, or in response to an alimony or child support garnishment order.
- Monthly payments computed by the TSP based upon the IRS life expectancy table, even if you separate before the year in which you reach age 55. However, if you change from such payments to a final single payment or to payments of a fixed dollar amount, either before you become age 59½ or within five years of the date of the first payment, whichever is later, you will be liable for the penalty tax on **all** payments you have received before age 59½.

- TSP distributions used for the payment of medical expenses and distributions to disabled persons that would be deductible under the Internal Revenue Code. (*See IRS Form 5329, Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts.*)

If you separate during or after the year in which you reach age 55, any amounts you receive directly from the TSP after your separation will not be subject to the penalty tax. However, if you transfer or roll your payment over to a traditional IRA, the penalty tax applies to any payments you receive from the IRA before age 59½, even if you separated during or after the year in which you became age 55.

For financial hardship in-service withdrawals, there is an early withdrawal penalty tax of 10% if you take the withdrawal before you become age 59½. (*See the tax notice "Important Tax Information About TSP In-Service Withdrawal Payments."*)

Special Note for Uniformed Services Accounts

The early withdrawal penalty tax does not apply to that portion of your withdrawal (or taxable loan distribution) which represents contributions from combat zone pay.

5. Additional Tax Information

Taxable Distribution of TSP Loan Due to Separation from Service

If you separate from Federal civilian service or the uniformed services with an outstanding TSP loan and you do not repay the entire loan, a taxable distribution of your outstanding loan balance must be declared before a withdrawal can be processed. (You may want to elect additional withholding from your TSP withdrawal or from other payments made to you in the same year to cover the tax you must pay on your loan distribution.)

You may deposit any amount up to the taxable amount of the distribution into a traditional IRA or an eligible employer plan using your personal funds, thereby avoiding current tax (and the early withdrawal penalty tax, if applicable). You must make the deposit within 60 days of the date of declaration of the taxable distribution.

Special Note for Uniformed Services Accounts

If your account includes tax-exempt contributions (from combat zone pay) and you have a loan that is declared to be a taxable distribution, not all of the outstanding loan balance will be taxable. At the time the loan is declared to be a taxable distribution, the TSP will determine the proportions of the loan balance that are tax-exempt and taxable. The tax-exempt amount can also be deposited into a traditional IRA if the IRA will accept it.

Ten-Year Tax Option

If the payment you receive from the TSP qualifies as an **eligible lump sum distribution**, you may be able to lower the income tax you pay by using the **10-year tax option**.

An **eligible lump sum distribution** is one in which your total TSP account balance (if you have two accounts, your civilian and uniformed services TSP accounts, including tax-exempt balances, if any) is distributed to you within one tax year (the calendar year, for most taxpayers), regardless of whether this occurs in one or more payments. This means that an eligible lump sum distribution — whether distributed to you by the TSP in a series of monthly payments, in a subsequent payment made after your initial withdrawal, or in a taxable loan distribution — must be distributed to you in the same tax year. With the **10-year tax option**, your eligible lump sum distribution is taxed as if it were paid to you over 10 tax years.

The following rules apply to the 10-year tax option:

- The 10-year tax option is available only if you were age 50 before January 1, 1986.
- You must have been an **active participant** in the TSP for at least five years before the year in which your distribution is made. You are considered an active participant during a year if either you or your agency made a contribution to your TSP account during that year.
- You must use the 10-year tax option for all eligible lump sum distributions that you receive in the same tax year. This includes a withdrawal of your entire TSP account after separation and any taxable loan distribution. It also includes an eligible lump sum distribution from any plan described in I.R.C. § 401(a) or § 403(a) which is maintained by another employer.
- You can use the 10-year tax option only once in your lifetime.
- You must use the tax rates in effect in 1986.
- If you transfer or roll over all or any part of your distribution, you cannot use the 10-year tax option.

You can elect the 10-year tax option by filing IRS Form 4972, Tax on Lump Sum Distributions, with your annual income tax return.

Saver's Tax Credit

If you participate in the TSP during tax years 2002 through 2006, you may be eligible for a tax credit of up to $1,000 on your Federal income tax return for each year you contribute to the plan. However, the amount of the tax credit may be offset by any taxable and non-taxable distributions paid directly to you from the TSP. This benefit, called the Saver's Tax Credit, is available to participants with an adjusted gross income of no more than $50,000 if married filing jointly, $37,500 if head of household, or $25,000 if single or married filing separately. For more information about this tax credit, consult your tax advisor or refer to IRS Publication 553, *Highlights of 2001 Tax Changes*.

6. TSP Service Office Information

If you have any questions regarding this notice, please contact the TSP Service Office at 1-877-968-3778 (TDD: 1-877-847-4385). Outside the U.S. and Canada, please call 1-504-255-8777. You can also write to:

TSP Service Office
National Finance Center
P.O. Box 61500
New Orleans, LA 70161-1500