



Important Tax Information About TSP In-Service Withdrawal Payments

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. This notice summarizes the tax rules that apply to TSP in-service withdrawals, i.e., age-based (age 59½ or older) and financial hardship withdrawals. 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; however, because the tax rules are complex, 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 uniformed services TSP account. (This is not true for the earnings attributable to contributions from combat zone pay; all earnings are taxable when they are distributed from the 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.*)

Unless otherwise noted, the following discussion applies only to the taxable portion of an in-service withdrawal.

1. Tax Withholding

Age-Based Withdrawals

Age-based in-service withdrawals are the only TSP payments made to participants before they separate from Federal civilian service or the uniformed services which are considered **eligible rollover distributions**, and

the following Federal income tax withholding rules apply. (**The TSP does not withhold amounts for state or local income tax.**)

- The mandatory tax withholding on 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 your eligible rollover distribution by asking the TSP to transfer that amount to a “traditional IRA” or an eligible employer plan.¹ 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, and submitting it to the TSP Service Office along with your in-service withdrawal request.² Line 1 and Line 2 are not valid elections for this type of payment.

Financial Hardship Withdrawals

A financial hardship in-service withdrawal is a **non-periodic payment** and cannot be transferred or rolled over to a traditional IRA or an eligible employer plan. The TSP will withhold 10% for Federal income tax from financial hardship in-service withdrawal payments unless the TSP Service Office receives IRS Form W-4P, Withholding Certificate for Pension or Annuity Payments, from you.² If you submit Form W-4P, you may elect:

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.

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.

- 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.

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

2. Transferring or Rolling Over Your Age-Based In-Service Withdrawal

All or any part of your age-based in-service withdrawal 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 distribution 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 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 on any part of the payment that you do not transfer or roll over.
- 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 a traditional IRA or an 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 payment to a traditional IRA or an eligible employer plan instead of rolling it over to your IRA or plan yourself.

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 age-based withdrawal 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 withdrawal, 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 withdrawal 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 (or to your personal checking or savings account via EFT), as well as all transfers made to traditional IRAs or 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 payment was made, if that state has an income tax.

In January of the year that follows your payment, the TSP will send you IRS 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. **Be sure your agency and/or service keeps your TSP account address up to date so that you receive the form and other important information about your account.**

4. Early Withdrawal Penalty Tax

Under the Internal Revenue Code, an early withdrawal penalty tax of 10% is imposed on the amount of an in-service withdrawal payment that you receive directly from the TSP (including any tax withholding) **before you become age 59½**. Thus, if you request a financial hardship withdrawal and are younger than age 59½, the penalty tax will apply to you. The penalty tax is in addition to the ordinary income tax that you pay on TSP payments.

The early withdrawal penalty tax does not apply to TSP distributions used for the payment of medical expenses which would be deductible under the Internal Revenue Code. (See IRS Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts.)

Special Note for Uniformed Services Accounts

The early withdrawal penalty tax does not apply to that portion of your withdrawal which represents contributions from combat zone pay.

5. 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. 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.

6. 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 nontaxable distributions, including in-service withdrawal payments, 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*.

7. 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