



Tax Information for TSP Participants Who Request Changes in Monthly Payments

If you are withdrawing your account in a series of monthly payments, you can have the TSP send you your remaining account balance in a final single payment at any time. You also have the opportunity to change your monthly payments once a year.¹ You can request a different dollar amount, or you can make a one-time-only change from TSP-computed payments to a specified dollar amount. To make these changes, submit Form TSP-73, Change in Monthly Payments, or Form TSP-U-73 if you are a member of the uniformed services.

Making such changes may affect the way your payments are taxed. The TSP cannot give tax advice; we are providing this tax information to let you know how Federal tax rules could apply to changes you may make. (The TSP does not withhold for state or local income tax, although we do report all TSP distributions on IRS Form 1099-R to your state of residence at the time of the payment if your state has an income tax.) Because tax rules are complex, you may also wish to speak with a tax advisor or with state or local tax officials.

Changing to a final single payment

For Federal income tax purposes, a final single payment from the TSP is categorized as an “eligible rollover distribution.” For this type of distribution, the IRS requires the TSP to withhold a mandatory 20% for Federal income taxes. You cannot waive this withholding. However, the TSP will not withhold taxes on amounts that are transferred directly to a traditional individual retirement account (IRA), an eligible employer plan,² or a Roth IRA³. If your payment is sent directly to you, 20% will be withheld, but you will have 60 days to roll over all or part of it to a traditional IRA, eligible employer plan, or Roth IRA.

If you elect to transfer or roll over your payment into a **traditional IRA or eligible employer plan**, tax on the amount you transfer or roll over will be deferred until you withdraw the money from that IRA or plan. Alternatively, if you are eligible and elect to transfer or roll over your payment into a **Roth IRA**, you will have to pay tax on that amount because the Roth IRA can only accept after-tax dollars; the tax liability is incurred for the year of the transfer. You will also have to pay tax on any amounts not transferred or rolled over in the current year.

Money the TSP withholds for taxes from your distribution may or may not be enough to

cover your tax liability. To have additional tax withheld, you can complete IRS Form W-4P.

Changing your monthly payments

IRS rules for withholding and for transferring or rolling over your payments to avoid withholding will depend on how the IRS categorizes your new monthly payments. How the payments are categorized will depend upon the number of monthly payments you will receive after the change you request goes into effect. (To determine the number of monthly payments you will receive, divide your previous year’s final account balance by the monthly dollar amount you will be receiving after the change. For example, if you are requesting a change in monthly payments beginning in 2008, you should divide your estimated account balance for December 31, 2007, by the dollar amount you expect to receive each month after the change goes into effect.)

If you will be receiving fewer than 120 payments, the IRS will categorize your monthly payments as an eligible rollover distribution. For Federal income tax purposes, the IRS will treat such payments the same way it treats a final single payment. Alternatively, if you will be receiving 120 payments or more, the IRS will categorize your payments as “periodic payments.” You cannot

¹ You can do this until December 15 of any year to become effective January 1 of the following year.

² A **traditional IRA**, which accepts pre-tax dollars, is any IRA that is not a Roth IRA, a SIMPLE IRA, or an education 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; and a section 457(b) plan maintained by a governmental employer.

³ A **Roth IRA** accepts only after-tax dollars, but provides tax-free growth. You are not eligible for a Roth transfer if either of the following conditions applies: (1) your modified adjusted gross income is over \$100,000, or (2) you are married and file a separate return.

transfer or roll over periodic payments to an IRA or an eligible employer plan, and withholding for periodic payments will be based on IRS withholding requirements for a person who is married with three dependents. However, using IRS Form W-4P, you can ask the TSP to increase, decrease, or waive the withholding for your periodic payments.

Early withdrawal tax penalty

If you separated from service before age 55 and are changing your TSP-computed monthly payments to monthly payments based on a fixed dollar amount or to a final single payment, see IRS Publication 575, *Pension and Annuity Income*. You may be subject to an early withdrawal penalty tax as a result of your change.

Receiving required minimum distributions through your monthly payments

If you are age 70½ or older and receiving monthly payments, the Internal Revenue Code requires that you receive a minimum distribution from your TSP account each tax year. Depending upon how much money you are required to receive, all or part of your monthly payments will be applied to that required minimum distribution. If you are receiving monthly payments that are expected to last less than 120 months, the portion of your payments that is paid as a required minimum distribution will have 10% withholding (under the IRS rules governing “non-periodic payments”). The remaining portion of your payments will be subject to the rules governing “eligible rollover distributions.” Consequently, there will be a mandatory 20% withholding on that portion of your payments, unless you transfer them to an IRA or an eligible employer plan.

All required minimum distribution payments that are paid under any other type of monthly payment schedule will be taxed under the IRS withholding rules for “periodic payments” (i.e., withholding will be for a person who is married with three dependents).

Required minimum distribution payments, regardless of withholding, are not eligible to be transferred to an IRA or an eligible employer plan.

Special note to former members of the uniformed services

TSP accounts for members of the uniformed services may include contributions from pay that is subject to the combat zone tax exclusion. That pay, earned in a combat zone, is exempt from Federal income tax. Consequently, monthly payments that include contributions from that pay may be transferred or rolled over into a traditional IRA or a Roth IRA or transferred to certain eligible employer plans, but **only if** the IRA or plan certifies that it will accept tax-exempt money.

Resources

You can obtain TSP forms from the TSP Web site, www.tsp.gov, or by calling the TSP 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 fax a written request to 1-866-817-5023 or write to the TSP at the address on the TSP Web site. For IRS publications, see the IRS Web site, www.irs.gov, or call 1-800-TAX-FORMS.

How Changes in Monthly Payments Can Affect Your Taxes

Type of payment after change	Type of payment for IRS purposes	Eligible for transfer or roll over?	Withholding rate	Can you increase withholding?	Can you decrease withholding?	Can you waive withholding?
Final single payment	Eligible rollover distribution	Yes	20% mandatory	Yes — complete line 3 of IRS Form W-4P ⁴	No	No
Monthly dollar amount paid out over less than 120 months⁵	Eligible rollover distributions	Yes	20% mandatory	Yes — complete line 3 of IRS Form W-4P ⁴	No	No
Monthly dollar amount paid out over 120 months or more⁶	Periodic payments	No	Based on married with 3 dependents	Yes — complete line 2 of IRS Form W-4P ⁴ to change exemptions and line 3 for additional dollar amount	Yes — complete line 2 of IRS Form W-4P ⁴	Yes — complete line 1 of IRS Form W-4P ⁴
Required minimum distribution⁷	Non-periodic payments	No	10%	Yes — complete line 3 of IRS Form W-4P ⁴	No	Yes — complete line 1 of IRS Form W-4P ⁴

⁴ IRS Form W-4P is available from the TSP Web site and from the IRS.

⁵ If the payment is satisfying the IRS required minimum distribution amount, see the “Required minimum distribution” section of this chart.

⁶ Payments are treated as periodic even if they are satisfying the IRS required minimum distribution amount.

⁷ Required minimum distributions are **not** treated as non-periodic payments (for IRS purposes) if they are part of monthly payments that are expected to be paid over 120 months or more, or are part of monthly payments that are based on the IRS life expectancy table. In these cases, taxes are based on withholding for a married person with 3 dependents, under the IRS withholding rules for periodic payments.