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Tax Guide to U.S. Civil Service Retirement Benefits

For use in preparing

2001 Returns

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Contents

Important Changes for 2002

Rollovers. For distributions made after 2001, you can roll over certain amounts from the CSRS, the FERS, or the TSP, to a tax-sheltered annuity plan (403(b) plan) or a state or local government section 457 deferred compensation plan. See *Rollover Rules* in *Part II*.

Time for making rollover. The 60-day period for completing the rollover of an eligible distribution may be extended for distributions made after 2001 in certain cases of casualty, disaster, or other events beyond your reasonable control. See *Rollover Rules* in *Part II*.

Rollover by surviving spouse. You may be able to roll over a distribution made after 2001 you receive as the surviving spouse of a deceased employee into a qualified retirement plan or a traditional IRA. See *Rollover Rules* in *Part II*.

Important Reminder

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling **1−800−THE−LOST (1−800−843−5678)** if you recognize a child.

Introduction

This publication explains how the federal income tax rules apply to civil service retirement benefits received by retired federal employees (including those disabled) or their survivors. These benefits are paid primarily under the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS).

Tax rules for annuity benefits. Part of the annuity benefits you receive is a tax-free recovery of your contributions to the CSRS or FERS. The rest of your benefits are taxable. If your annuity starting date is after November 18, 1996, you must use the Simplified Method to figure the taxable and tax-free parts. If your annuity starting date is before November 19, 1996, you generally could have chosen to use the Simplified Method or the General Rule. See Part II, *Rules for Retirees*.

Thrift Savings Plan. The Thrift Savings Plan (TSP) provides federal employees with the same savings and tax benefits that many private employers offer their employees. This plan is similar to private sector 401(k) plans. You can defer tax on part of your pay by having it contributed to your account in the plan. The contributions and earnings on them are not taxed until they are distributed to you. See *Thrift Savings Plan* in Part II.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

You can e-mail us while visiting our web site at **www.irs.gov**.

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We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

Useful Items

You may want to see:

Publication

- ❏ **524** Credit for the Elderly or the Disabled
- ❏ **575** Pension and Annuity Income
- ❏ **590** Individual Retirement Arrangements (IRAs)
- ❏ **939** General Rule for Pensions and Annuities

Form (and Instructions)

- ❏ **CSA 1099R** Statement of Annuity Paid
- ❏ **CSF 1099R** Statement of Survivor Annuity Paid
- ❏ **1099−R** Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
- ❏ **5329** Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts

See *How To Get Tax Help* near the end of this publication for information about getting publications and forms.

Part I
General Information

This part of the publication contains information that can apply to most recipients of civil service retirement benefits.

Refund of Contributions

If you leave federal government service or transfer to a job not under the CSRS or FERS and you are not eligible for an immediate annuity, you can choose to receive a refund of the money in your CSRS or FERS retirement account. The refund will include both regular and voluntary contributions you made to the fund, plus any interest payable.

If the refund includes only your contributions, none of the refund is taxable. If it includes any interest, the interest is taxable unless you roll it over into another qualified plan or a traditional individual retirement arrangement (IRA). If you do not have the Office of Personnel Management (OPM) transfer the interest to an IRA or other plan in a direct rollover, tax will be withheld at a 20% rate. See *Rollover Rules* in Part II for information on how to make a rollover.

If you do not roll over interest included in your refund, it may qualify as a lump-sum distribution eligible for capital gain treatment or the 10-year tax option. If you separate from service before the calendar year in which you reach age 55, it may be subject to an additional 10% tax on early distributions. For more information, see *Lump-Sum Distributions* and *Tax on Early Distributions* in Publication 575.

TIP *Interest is not paid on contributions to the CSRS for service after 1956 unless your service was for more than 1 year but not more than 5 years. Therefore, many employees who withdraw their contributions under the CSRS do not get interest and do not owe any tax on their refund.*

Tax Withholding and Estimated Tax

The CSRS or FERS annuity you receive is subject to federal income tax withholding based on tables prepared by the Internal Revenue Service, unless you choose not to have tax withheld. OPM will tell you how to make the choice. The choice for no withholding remains in effect until you change it. These withholding rules also apply to a disability annuity, whether received before or after minimum retirement age.

If you choose not to have tax withheld, or if you do not have enough tax withheld, you may have to make estimated tax payments.

CAUTION *You may owe a penalty if the total of your withheld tax and estimated tax does not cover most of the tax shown on your return. Generally, you will owe the penalty if the additional tax you must pay with your return is $1,000 or more and more than 10% of the tax shown on your return. For more information, including exceptions to the penalty, see chapter 4 of Publication 505,* Tax Withholding and Estimated Tax.

Form CSA 1099R. Form CSA 1099R is mailed to you by OPM each year. It will show any tax you had withheld. File a copy of Form CSA 1099R with your tax return if any federal income tax was withheld.

Choosing no withholding on payments outside the United States. The choice for no withholding generally cannot be made for annuity payments to be delivered outside the United States and its possessions.

To choose no withholding if you are a U.S. citizen or resident, you must provide OPM with your home address in the United States or its possessions. Otherwise, OPM has to withhold tax. For example, OPM must withhold if you provide a U.S. address for a nominee, trustee, or agent (such as a bank) to whom the benefits are to be delivered, but you do not provide your own U.S. home address.

You also may choose no withholding if you certify to OPM that you are ***not*** a U.S. citizen, a U.S. resident alien, or someone who left the United States to avoid tax. But if you so certify, you may be subject to the 30% flat rate withholding that applies to nonresident aliens. For details, see Publication 519, *U.S.Tax Guide for Aliens.*

Withholding certificate. If you give OPM a Form W−4P−A, *Election of Federal Income Tax Withholding,* choosing withholding, your annuity will be treated like wages for income tax withholding purposes. If you do not make a choice, OPM must withhold as if you were married with three withholding allowances.

To change the amount of tax withholding or to stop withholding, call OPM's Retirement Information Office at **1−888−767−6738** (customers within the local Washington, D.C. calling area must call **202−606−0500**), or call Annuitant Express at **1−800−409−6528.** No special form is needed. You will need your retirement claim number (CSA or CSF) and your social security number when you call. If you have TTY/TDD equipment, call **1−800−878−5707**.

You can also change the amount of withholding or stop withholding through the Internet at **www.servicesonline.opm.gov**. You will need your retirement claim number (CSA or CSF) and your Personal Identification Number (PIN). To get a PIN, call the OPM's Retirement Information Office. (See the preceding paragraph for telephone numbers.)

Withholding from certain lump-sum payments. If you leave the federal government before becoming eligible to retire and you apply for a refund of your CSRS or FERS contributions, or you die without leaving a survivor eligible for an annuity, you or your beneficiary will receive a distribution of your contributions to the retirement plan plus any interest payable. Tax will be withheld at a 20% rate on the interest distributed. However, tax will not be withheld on the interest if you roll it over to a traditional IRA or a qualified plan by having OPM transfer it directly to the traditional IRA or other plan. See *Rollover Rules* in Part II. If you receive only your contributions, no tax will be withheld.

If you retire and elect to receive a reduced annuity and a lump-sum payment under the alternative annuity option, tax will be withheld at a 20% rate on the taxable part of the lump-sum payment received. (See *Alternative Annuity Option* in Part II for information about this option.) However, no tax will be withheld from the lump sum if you roll the taxable part over to a traditional IRA or a qualified plan by having OPM transfer the taxable part directly to a traditional IRA or other plan.

Withholding from Thrift Savings Plan payments. Generally, a distribution that you receive from the Thrift Savings Plan (TSP) is subject to federal income tax withholding. The amount withheld is:

- 20% if the distribution is an eligible rollover distribution, or
- 10% if it is a nonperiodic distribution other than an eligible rollover distribution, or
- An amount determined by treating the payment as wages, if it is a periodic distribution.

However, you can usually choose not to have tax withheld from TSP payments other than eligible rollover distributions. By January 31 after the end of the year in which you receive a distribution, the TSP will issue ***Form 1099−R*** showing the total distributions you received in the prior year and the amount of tax withheld.

For a detailed discussion of withholding on distributions from the TSP, see *Important Tax Information About Payments From Your TSP,* available from your agency personnel office or from the TSP.

The above document is also available on the Internet at **www.tsp.gov**. Select "Forms & Pubs," then select "Other Documents."

Estimated tax. Generally, you should make estimated tax payments for 2002 if you expect to owe at least $1,000 in tax (after subtracting your withholding and credits) and you expect your withholding and your credits to be less than the smaller of:

1) 90% of the tax to be shown on your income tax return for 2002, or

2) The tax shown on your 2001 income tax return (112% of that amount if the adjusted gross income shown on the return was more than $150,000 ($75,000 if your filing status for 2002 will be married filing separately)). The return must cover all 12 months.

You do not have to pay estimated tax for 2002 if you were a U.S. citizen or resident for all of 2001 and you had no tax liability for the full 12-month 2001 tax year.

Form 1040–ES contains a worksheet that you can use to see if you should make estimated tax payments. For more information, see chapter 2 in Publication 505.

Filing Requirements

If your gross income, including the taxable part of your annuity, is less than a certain amount, you generally do not have to file a federal income tax return. The gross income filing requirements are in the instructions to the Form 1040, 1040A, or 1040EZ, that you get each year. You should check these requirements closely because they change occasionally.

Children. If you are the surviving spouse of a federal employee or retiree and your monthly annuity check includes a survivor annuity for one or more children, each child's annuity counts as his or her own income (not yours) for federal income tax purposes.

If your child can be claimed as a dependent, treat his or her annuity as unearned income to apply the filing requirements.

Form CSF 1099R. By January 31 after the end of each tax year, you should receive Form CSF 1099R, which will show the total amount of the annuity you received in the past year. It also should show, separately, the survivor annuity for a child or children. Only the part that is each individual's survivor annuity should be shown on that individual's Form 1040 or 1040A.

If your Form CSF 1099R does not show separately the amount paid to you for a child or children, attach a statement to your return, along with a copy of Form CSF 1099R, explaining why the amount shown on the tax return differs from the amount shown on Form CSF 1099R.

You may request a *Summary of Payments,* showing the amounts paid to you for your child(ren), from OPM by calling OPM's Retirement Information Office at **1–888–767–6738** (customers within the local Washington, D.C. calling area must call **202–606–0500**). You will need your CSF claim number and your social security number when you call.

Taxable part of annuity. To find the taxable part of each annuity, see the discussion in Part IV, *Rules for Survivors of Federal Employees,* or Part V, *Rules for Survivors of Federal Retirees,* whichever applies.

Part II
Rules for Retirees

This part of the publication is for retirees who retired on nondisability retirement. If you retired on disability, see Part III, *Rules for Disability Retirement and Credit for the Elderly or the Disabled,* later.

Annuity statement. The statement you received from OPM when your CSRS or FERS annuity was approved shows the ***commencing date*** (the annuity starting date), the ***gross monthly rate*** of your annuity benefit, and your ***total contributions*** to the retirement plan (your cost). You will use this information to figure the tax-free recovery of your cost.

Annuity starting date. If you retire from federal government service on a regular annuity, your annuity starting date is the commencing date on your annuity statement from OPM. If something delays payment of your annuity, such as a late application for retirement, it does not affect the date your annuity begins to accrue or your annuity starting date.

Gross monthly rate. This is the amount you were to get after any adjustment for electing a survivor's annuity or for electing the lump-sum payment under the alternative annuity option (if either applied) but before any deduction for income tax withholding, insurance premiums, etc.

Your cost. Your monthly annuity payment contains an amount on which you have previously paid income tax. This amount represents part of your contributions to the retirement plan. Even though you did not receive the money that was contributed to the plan, it was included in your gross income for federal income tax purposes in the years it was taken out of your pay.

The cost of your annuity is the total of your contributions to the retirement plan, as shown on your annuity statement from OPM. If you elected the alternative annuity option, it includes any deemed deposits and any deemed redeposits that were added to your lump-sum credit. (See *Lump-sum credit* under *Alternative Annuity Option,* later.)

If you repaid contributions that you had withdrawn from the retirement plan earlier, or if you paid into the plan to receive full credit for service not subject to retirement deductions, the entire repayment, including any interest, is a part of your cost. You cannot claim an interest deduction for any interest payments. You cannot treat these payments as voluntary contributions; they are considered regular employee contributions.

Recovering your cost tax free. How you figure the tax-free recovery of the cost of your CSRS or FERS annuity depends on your annuity starting date.

- If your annuity starting date is before July 2, 1986, either the Three-Year Rule or the General Rule (both discussed later) applies to your annuity.
- If your annuity starting date is after July 1, 1986, and before November 19, 1996, you could have chosen

to use either the General Rule or the Simplified Method.

- If your annuity starting date is after November 18, 1996, you must use the Simplified Method.

Under both the General Rule and the Simplified Method, each of your monthly annuity payments is made up of two parts: the tax-free part that is a return of your cost, and the taxable part that is the amount of each payment that is more than the part that represents your cost. The tax-free part is a fixed dollar amount. It remains the same, even if your annuity is increased. Generally, this rule applies as long as you receive your annuity. However, see *Exclusion limit,* later.

Choosing a survivor annuity after retirement. If you retired without a survivor annuity and report your annuity under the Simplified Method, do not change your tax-free monthly amount even if you later choose a survivor annuity.

If you retired without a survivor annuity and report your annuity under the General Rule, you must figure a new exclusion percentage if you later choose a survivor annuity. To figure it, reduce your cost by the amount you previously recovered tax free. Figure the expected return as of the date the reduced annuity begins. For details on the General Rule, see Publication 939.

Canceling a survivor annuity after retirement. If you notify OPM that your marriage has ended, your annuity might be increased to remove the reduction for a survivor benefit. The increased annuity does not change the cost recovery you figured at the annuity starting date. The tax-free part of each annuity payment remains the same.

For more information about choosing or canceling a survivor annuity after retirement, contact OPM's Retirement Information Office at **1–888–767–6738** (customers within the local Washington, D.C. calling area must call **202–606–0500**).

Exclusion limit. If your annuity starting date is after 1986, the total amount of annuity income that you (or the survivor annuitant) can exclude over the years as a return of your cost may not exceed your total cost. Annuity payments you or your survivors receive after the total cost in the plan has been recovered are fully taxable.

Example. Your annuity starting date is after 1986 and you exclude $100 a month under the Simplified Method. If your cost is $12,000, the exclusion ends after 10 years (120 months). Thereafter, your entire annuity is taxable.

Annuity starting date before 1987. If your annuity starting date is before 1987, you continue to take your monthly exclusion figured under the General Rule or Simplified Method for as long as you receive your annuity. If you chose a joint and survivor annuity, your survivor continues to take that same exclusion. The total exclusion may be more than your cost.

Deduction of unrecovered cost. If your annuity starting date is after July 1, 1986, and the cost of your annuity has not been fully recovered at your (or the survivor annuitant's) death, a deduction is allowed for the unrecovered cost. The deduction is claimed on your (or your survivor's) final tax return as a miscellaneous itemized deduction (not subject to the 2%-of-adjusted-gross income limit). If your annuity starting date is before July 2, 1986, no tax benefit is allowed for any unrecovered cost at death.

Simplified Method

If your annuity starting date is after November 18, 1996, you must use the Simplified Method to figure the tax-free part of your CSRS or FERS annuity. (OPM has figured the taxable amount of your annuity shown on your Form CSA 1099R using the Simplified Method.) You could have chosen to use either the Simplified Method or the General Rule if your annuity starting date is after July 1, 1986, but before November 19, 1996. The Simplified Method does not apply if your annuity starting date is before July 2, 1986.

Under the Simplified Method, you figure the tax-free part of each full monthly payment by dividing your cost by a number of months based on your age. This number will differ depending on whether your annuity starting date is on or before November 18, 1996, or later. If your annuity starting date is after 1997 and your annuity includes a survivor benefit for your spouse, this number is based on your combined ages.

Table 1. Use Table 1, *Simplified Method Worksheet* (near the end of this publication), to figure your taxable annuity. Be sure to keep the completed worksheet. It will help you figure your taxable amounts for later years.

TIP

Instead of Table 1, you can generally use the Simplified Method Worksheet in the instructions for Form 1040 or Form 1040A to figure your taxable annuity. However, you **must** *use Table 1 and Table 2 in this publication if you chose the alternative annuity option. See* Alternative Annuity Option, *later.*

Line 2. See *Your cost,* earlier, for an explanation of your cost in the plan. If your annuity starting date is after November 18, 1996, and you chose the alternative annuity option (explained later), you must reduce your cost by the tax-free part of the lump-sum payment you received.

Line 3. Find the appropriate number from one of the tables at the bottom of the worksheet. If your annuity starting date is after 1997, use:

- Table 1 for an annuity ***without*** a survivor benefit, or
- Table 2 for an annuity ***with*** a survivor benefit.

If your annuity starting date is before 1998, use Table 1.

Line 6. If you retired before 2001, the amount previously recovered tax free that you must enter on line 6 is the total amount from line 10 of last year's worksheet. If your annuity starting date is before November 19, 1996, and you chose the alternative annuity option, it includes the tax-free part of the lump-sum payment you received.

Example. Bill Kirkland retired from the federal government on April 30, 2001, under an annuity that will provide a survivor benefit for his wife, Kathy. His annuity starting date is May 3, 2001. He must use the Simplified Method to figure the tax-free part of his annuity benefits.

Bill's monthly annuity benefit is $1,000. He had contributed $24,700 to his retirement plan and had received no distributions before his annuity starting date. At his annuity starting date, he was 65 and Kathy was 57.

Bill's completed worksheet (Table 1) is shown on the next page. To complete line 3, he used Table 2 at the bottom of the worksheet and found the number in the second column opposite the age range that includes 122 (his and Kathy's combined ages). Bill keeps a copy of the completed worksheet for his records. It will help him (and Kathy, if she survives him) figure the taxable amount of the annuity in later years.

Bill's tax-free monthly amount is $80. (See line 4 of the worksheet.) If he lives to collect more than 310 monthly payments, he will have to include in his gross income the full amount of any annuity payments received after 310 payments have been made.

If Bill does not live to collect 310 monthly payments and his wife begins to receive monthly payments, she will also exclude $80 from each monthly payment until 310 payments (Bill's and hers) have been collected. If she dies before 310 payments have been made, a miscellaneous itemized deduction (not subject to the 2%-of-adjusted-gross-income limit) will be allowed for the unrecovered cost on her final income tax return.

General Rule

If your annuity starting date is after November 18, 1996, you cannot use the General Rule to figure the tax-free part of your CSRS or FERS annuity. If your annuity starting date is after July 1, 1986, but before November 19, 1996, you could have chosen to use either the General Rule or the Simplified Method. If your annuity starting date is before July 2, 1986, you could have chosen to use the General Rule only if you could not use the Three-Year Rule.

Under the General Rule, you figure the tax-free part of each full monthly payment by multiplying the initial gross monthly rate of your annuity by an exclusion percentage. Figuring this percentage is complex and requires the use of actuarial tables. For these tables and other information about using the General Rule, see Publication 939.

Three-Year Rule

If your annuity starting date was before July 2, 1986, you probably had to report your annuity using the Three-Year Rule. Under this rule, you excluded all the annuity payments from income until you fully recovered your cost. After your cost was recovered, all payments became fully taxable. You cannot use another rule to again exclude amounts from income.

The Three-Year Rule was repealed for retirees whose annuity starting date is after July 1, 1986.

Alternative Annuity Option

If you are a nondisability retiree under either CSRS or FERS, you may be able to choose the ***alternative annuity option.*** This option is generally available only to retirees with certain life-threatening illnesses or other critical medical conditions. If you choose this option, you will receive a lump-sum payment equal to your total regular contributions to the retirement plan plus any interest that applies. Your monthly annuity is then reduced by about 5 to 15 percent to adjust for this payment.

Lump-Sum Payment

The lump-sum payment you receive under the alternative annuity option generally has a tax-free part and a taxable part. The tax-free part represents part of your cost. The taxable part represents part of the earnings on your annuity contract. If your lump-sum credit (discussed later) includes a deemed deposit or redeposit, the taxable amount may be more than the lump-sum payment. You must include the taxable part of the lump-sum payment in your income for the year you receive the payment unless you roll it over into another qualified plan or a traditional IRA. If you do not have OPM transfer the taxable amount to an IRA or other plan in a direct rollover, tax will be withheld at a 20% rate. See *Rollover Rules,* later, for information on how to make a rollover.

CAUTION *OPM can make a direct rollover only up to the amount of the lump-sum payment. Therefore, to defer tax on the full taxable amount if it is more than the payment, you must roll over the difference using your own funds.*

The taxable part of the lump-sum payment does ***not*** qualify as a lump-sum distribution eligible for capital gain treatment or the 10-year tax option. It may also be subject to an additional 10% tax on early distributions if you separate from service before the calendar year in which you reach age 55. For more information, see *Lump-Sum Distributions* and *Tax on Early Distributions* in Publication 575.

Table 2. Use Table 2, *Worksheet for Lump-Sum Payment* (near the end of this publication), to figure the taxable part of your lump-sum payment. Be sure to keep the completed worksheet for your records.

To complete the worksheet, you will need to know the amount of your lump-sum credit and the present value of your annuity contract.

Lump-sum credit. Generally, this is the same amount as the lump-sum payment you receive (the total of your contributions to the retirement system and interest on those contributions). However, for purposes of the alternative annuity option, your lump-sum credit may also include deemed deposits and redeposits that OPM advanced to your retirement account so that you are given credit for the service they represent. Deemed deposits (including interest) are for federal employment during which no retirement contributions were taken out of your pay. Deemed redeposits (including interest) are for any refunds of retirement contributions that you received and did not repay. You are

Filled-In Table 1 for Bill Kirkland Example

Table 1. **Simplified Method Worksheet** (Keep For Your Records)

See the instructions for the worksheet in Part II under *Simplified Method.*

1.	Enter the total annuity received this year. Also add this amount to the total for Form 1040, line 16a, or Form 1040A, line 12a	$ 8,000
2.	Enter your cost in the plan at the annuity starting date, plus any death benefit exclusion	24,700
	NOTE: *If your annuity starting date was* ***before this year*** *and you completed this worksheet last year, skip line 3 and enter the amount from line 4 of last year's worksheet on line 4 below. Otherwise, go to line 3.*	
3.	Enter the appropriate number from Table 1 below. **But** if your annuity starting date was **after** 1997 **and** the payments are for your life and that of your beneficiary, enter the appropriate number from Table 2 below	310
4.	Divide line 2 by line 3	80
5.	Multiply line 4 by the number of months for which this year's payments were made. If your annuity starting date was before 1987, enter this amount on line 8 below and skip lines 6, 7, 10, and 11. Otherwise go to line 6	$ 640
6.	Enter any amounts previously recovered tax free in years after 1986	0
7.	Subtract line 6 from line 2	24,700
8.	Enter the smaller of line 5 or line 7	640
9.	**Taxable annuity for year.** Subtract line 8 from line 1. Enter the result, but not less than zero. Also add this amount to the total for Form 1040, line 16b, or Form 1040A, line 12b. If your Form CSA 1099R or Form CSF 1099R shows a larger amount, use the amount on this line instead	$ 7,360
10.	Add lines 6 and 8	640
11.	**Balance of cost to be recovered.** Subtract line 10 from line 2	$ 24,060

Table 1 for Line 3 Above

IF the age at annuity starting date was. . .	AND your annuity starting date was— **before** November 19, 1996, enter on line 3. . .	**after** November 18, 1996, enter on line 3. . .
55 or under	300	360
56–60	260	310
61–65	240	260
66–70	170	210
71 or older	120	160

Table 2 for Line 3 Above

IF the combined ages at annuity starting date were. . .	THEN enter on line 3. . .
110 and under	410
111–120	360
121–130	310
131–140	260
141 or older	210

Filled-In Table 2 for David Brown Example

Table 2. **Worksheet for Lump-Sum Payment** (Keep For Your Records)
See the instructions for the worksheet in Part II under *Alternative Annuity Option.*

1.	Enter your lump-sum credit (your cost in the plan at the annuity starting date) . . .	$ 31,000
2.	Enter the present value of your annuity contract	155,000
3.	Divide line 1 by line 2	.20
4.	**Tax-free amount.** Multiply line 1 by the number on line 3. (*Caution: Do not include this amount on line 6 of Table 1 in this publication.*) . . .	$ 6,200
5.	**Taxable amount (net cost in the plan).** Subtract line 4 from line 1. Include this amount in the total on line 16b of Form 1040 or line 12b of Form 1040A. Also, enter this amount on line 2 of Table 1 in this publication	$ 24,800

treated as if you had received a lump-sum payment equal to the amount of your lump-sum credit and then had made a repayment to OPM of the advanced amounts.

Present value of your annuity contract. The present value of your annuity contract is figured using actuarial tables provided by the IRS.

To find out the present value of your annuity contract, call the IRS Actuarial Branch 1 at **202−283−9717** (not a toll-free call).

Example. David Brown retired from the federal government in 2001, one month after his 55th birthday. He had contributed $31,000 to his retirement plan and chose to receive a lump-sum payment of that amount under the alternative annuity option. The present value of his annuity contract was $155,000. Using the Table 2 worksheet, he figures the taxable part of the lump-sum payment and his net cost in the plan. That worksheet is shown above.

Lump-sum payment in installments. If you choose the alternative annuity option, you usually will receive the lump-sum payment in two equal installments. You will receive the first installment after you make the choice upon retirement. The second installment will be paid to you, with interest, in the next calendar year. (Exceptions to the installment rule are provided for cases of critical medical need.)

Even though the lump-sum payment is made in installments, the overall tax treatment (explained at the beginning of this discussion) is the same as if the whole payment were paid at once. If the payment has a tax-free part, you must treat the taxable part as received first.

How to report. Add any actual or deemed payment of your lump-sum credit (defined earlier) to the total for line 16a, Form 1040, or line 12a, Form 1040A. Add the taxable part to the total for line 16b, Form 1040, or line 12b, Form 1040A, unless you roll over the taxable part to a traditional IRA or a qualified retirement plan.

If you receive the lump-sum payment in two installments, include any interest paid with the second installment on line 8a of either Form 1040 or Form 1040A.

Reduced Annuity

If you have chosen to receive a lump-sum payment under the alternative annuity option, you will also receive reduced monthly annuity payments. These annuity payments will each have a tax-free and a taxable part. To figure the tax-free part of each annuity payment, you must use the Simplified Method Worksheet (Table 1). For instructions on how to complete the worksheet, see *Table 1* under *Simplified Method,* earlier.

To complete line 2 of Table 1, you must reduce your cost in the plan by the tax-free part of the lump-sum payment you received. Enter as your net cost on line 2 the amount from line 5 of Table 2. Do ***not*** include the tax-free part of the lump-sum payment with other amounts recovered tax free (line 6 of Table 1) when limiting your total exclusion to your total cost.

Example. The facts are the same as in the example for David Brown in the preceding discussion. In addition, David received 10 annuity payments in 2001 of $1,200 each. Using the Table 1 worksheet, he figures the taxable part of his annuity payments. He completes line 2 by reducing his $31,000 cost by the $6,200 tax-free part of his lump-sum payment. His entry on line 2 is his $24,800 net cost in the plan (the amount from line 5 of Table 2). He does ***not*** include the tax-free part of his lump-sum payment on line 6 of Table 1. David's filled-in Table 1 worksheet is shown on the next page.

CAUTION

Reemployment after choosing the alternative annuity option. *If you chose this option when you retired and then you were reemployed by the federal government before retiring again, your Form CSA 1099R may show only the amount of your contributions to your retirement plan during your reemployment. If the amount on the form does not include all your contributions, disregard it and use your total contributions to figure the taxable part of your annuity payments.*

Annuity starting date before November 19, 1996. If your annuity starting date is before November 19, 1996, and you chose the alternative annuity option, the taxable and tax-free parts of your lump-sum payment and your annuity payments are figured using different rules. Under those rules, you do ***not*** reduce your cost in the plan (line 2 of Table 1) by the tax-free part of the lump-sum payment.

Filled-In Table 1 for David Brown Example

Table 1. **Simplified Method Worksheet** (Keep For Your Records)

See the instructions for the worksheet in Part II under *Simplified Method.*

1.	Enter the total annuity received this year. Also add this amount to the total for Form 1040, line 16a, or Form 1040A, line 12a	$ 12,000.00
2.	Enter your cost in the plan at the annuity starting date, plus any death benefit exclusion	24,800.00
	NOTE: *If your annuity starting date was* ***before this year*** *and you completed this worksheet last year, skip line 3 and enter the amount from line 4 of last year's worksheet on line 4 below. Otherwise, go to line 3.*	
3.	Enter the appropriate number from Table 1 below. **But** if your annuity starting date was **after** 1997 **and** the payments are for your life and that of your beneficiary, enter the appropriate number from Table 2 below	360
4.	Divide line 2 by line 3	68.89
5.	Multiply line 4 by the number of months for which this year's payments were made. If your annuity starting date was before 1987, enter this amount on line 8 below and skip lines 6, 7, 10, and 11. Otherwise go to line 6	$ 688.90
6.	Enter any amounts previously recovered tax free in years after 1986	-0-
7.	Subtract line 6 from line 2	24,800.00
8.	Enter the smaller of line 5 or line 7	688.90
9.	**Taxable annuity for year.** Subtract line 8 from line 1. Enter the result, but not less than zero. Also add this amount to the total for Form 1040, line 16b, or Form 1040A, line 12b. If your Form CSA 1099R or Form CSF 1099R shows a larger amount, use the amount on this line instead	$ 11,311.10
10.	Add lines 6 and 8	688.90
11.	**Balance of cost to be recovered.** Subtract line 10 from line 2	$ 24,111.10

Table 1 for Line 3 Above

IF the age at annuity starting date was. . .	AND your annuity starting date was— **before** November 19, 1996, enter on line 3. . .	**after** November 18, 1996, enter on line 3. . .
55 or under	300	360
56–60	260	310
61–65	240	260
66–70	170	210
71 or older	120	160

Table 2 for Line 3 Above

IF the combined ages at annuity starting date were. . .	THEN enter on line 3. . .
110 and under	410
111–120	360
121–130	310
131–140	260
141 or older	210

However, you must include that tax-free amount with other amounts previously recovered tax free (line 6 of Table 1) when limiting your total exclusion to your total cost.

Federal Gift Tax

If, through the exercise or nonexercise of an election or option, you provide an annuity for your beneficiary at or after your death, you have made a gift. The gift may be taxable for gift tax purposes. The value of the gift is equal to the value of the annuity.

Joint and survivor annuity. If the gift is an interest in a joint and survivor annuity where ***only*** you and your spouse can receive payments before the death of the last spouse to die, the gift will generally qualify for the unlimited marital deduction. This will eliminate any gift tax liability with regard to that gift.

If you provide survivor annuity benefits for someone other than your current spouse, such as your former spouse, the unlimited marital deduction will not apply. This may result in a taxable gift.

More information. For information about the gift tax, see Publication 950, *Introduction to Estate and Gift Taxes.*

Retirement During the Past Year

If you have recently retired, the following discussions covering annual leave, voluntary contributions, and community property may apply to you.

Annual leave. Treat a payment for accrued annual leave received on retirement as a salary payment. It is taxable as wages in the tax year you receive it.

Voluntary contributions. Voluntary contributions to the retirement fund are those made in addition to the regular contributions that were deducted from your salary. They also include the regular contributions withheld from your salary after you have the years of service necessary for the maximum annuity allowed by law. Voluntary contributions are not the same as employee contributions to the Thrift Savings Plan. See *Thrift Savings Plan*, later.

Additional annuity benefit. If you choose an additional annuity benefit from your voluntary contributions, it is treated separately from the annuity benefit that comes from the regular contributions deducted from your salary. This separate treatment applies for figuring the amounts to be excluded from, and included in, gross income. It does not matter that you receive only one monthly check covering both benefits. Each year you will receive a Form CSA 1099R that will show how much of your total annuity received in the past year was from each type of benefit.

Figure the taxable and tax-free parts of your additional monthly benefits from voluntary contributions using the rules that apply to regular CSRS and FERS annuities, as explained earlier in Part II.

Refund of voluntary contributions. If you choose a refund of your voluntary contributions plus accrued interest, the interest is taxable to you in the tax year it is distributed unless you roll it over to a traditional IRA or another qualified retirement plan. If you do not have OPM transfer the interest to a traditional IRA or other qualified retirement plan in a direct rollover, tax will be withheld at a 20% rate. See *Rollover Rules,* later. The interest does ***not*** qualify as a lump-sum distribution eligible for capital gain treatment or the 10-year tax option. It may also be subject to an additional 10% tax on early distributions if you separate from service before the calendar year in which you reach age 55. For more information, see *Lump-Sum Distributions* and *Tax on Early Distributions* in Publication 575.

Community property laws. State community property laws apply to your annuity. These laws will affect your income tax only if you file a return separately from your spouse.

Generally, the determination of whether your annuity is separate income (taxable to you) or community income (taxable to both you and your spouse) is based on your marital status and domicile when you were working. Regardless of whether you are now living in a community property state or a noncommunity property state, your current annuity may be community income if it is based on services you performed while married and domiciled in a community property state.

At any time, you have only one domicile even though you may have more than one home. Your domicile is your fixed and permanent legal home to which, when absent, you intend to return. The question of your domicile is mainly a matter of your intentions as indicated by your actions.

If your annuity is a mixture of community income and separate income, you must divide it between the two kinds of income. The division is based on your periods of service and domicile in community and noncommunity property states while you were married.

For more information, see Publication 555, *Community Property.*

Reemployment After Retirement

If you retired from federal service and are later reemployed by the federal government, you can continue to receive your annuity during reemployment. The employing agency will usually pay you the difference between your salary for your period of reemployment and your annuity. This amount is taxable as wages. Your annuity will continue to be taxed just as it was before. If you are still recovering your cost, you continue to do so. If you have recovered your cost, the annuity you receive while you are reemployed is generally fully taxable.

Nonresident Aliens

The following special rules apply to nonresident alien federal employees performing services outside the United States and to nonresident alien retirees and beneficiaries.

Special rule for figuring your total contributions. Your contributions to the retirement plan (your cost) also include the government's contributions to the plan to a certain extent. You include government contributions that would not have been taxable to you at the time they were contributed if they had been paid directly to you. For example, government contributions would not have been taxable to you if, at the time made, your services were performed outside the United States. Thus, your cost is increased by government contributions that you would have excluded as income from foreign services if you had received them directly as wages. This reduces the benefits that you, or your beneficiary, must include in income.

This method of figuring your total contributions does not apply to any contributions the government made on your behalf after you became a citizen or resident of the United States.

Limit on taxable amount. There is a limit on the taxable amount of payments received from the CSRS, the FERS, or the TSP by a nonresident alien retiree or nonresident alien beneficiary. This limited taxable amount is in the same proportion to the otherwise taxable amount that the retiree's total U.S. Government basic pay, other than tax-exempt pay for services performed outside the United States, is to the retiree's total U.S. Government basic pay for all services.

Basic pay includes regular pay plus any standby differential. It does not include bonuses, overtime pay, certain retroactive pay, uniform or other allowances, or lump-sum leave payments.

To figure the limited taxable amount of your CSRS or FERS annuity or your TSP distributions, use the following worksheet. (For an annuity, first complete Table 1 in this publication.)

Worksheet for Nonresident Alien

1. Enter the otherwise taxable amount of the CSRS or FERS annuity (from line 9 of Table 1) or TSP distributions . . .	$ ______
2. Enter the total U.S. Government basic pay other than tax-exempt pay for services performed outside the United States	______
3. Enter the total U.S. Government basic pay for all services	______
4. Divide line 2 by line 3	______
5. **Limited taxable amount.** Multiply line 1 by the number on line 4. Enter this amount on Form 1040NR, line 17b . .	______

Example 1. You are a nonresident alien who performed all services for the U.S. Government abroad as a nonresident alien. You retired and began to receive a monthly annuity of $200. Your total basic pay for all services for the U.S. Government was $100,000.

The taxable amount of your annuity using Table 1 in this publication is $720. Because you are a nonresident alien, you figure the limited taxable amount of your annuity as follows.

Worksheet for Nonresident Alien

1. Enter the otherwise taxable amount of the CSRS or FERS annuity (from line 9 of Table 1) or TSP distributions . . .	$ 720
2. Enter the total U.S. Government basic pay other than tax-exempt pay for services performed outside the United States	0
3. Enter the total U.S. Government basic pay for all services	100,000
4. Divide line 2 by line 3	0
5. **Limited taxable amount.** Multiply line 1 by the number on line 4. Enter this amount on Form 1040NR, line 17b . .	0

Example 2. You are a nonresident alien who performed services for the U.S. Government as a nonresident alien both within the United States and abroad. You retired and began to receive a monthly annuity of $240.

Your total basic pay for your services for the U.S. Government was $120,000—$40,000 was for work done in the United States and $80,000 was for your work done in a foreign country.

The taxable amount of your annuity figured using Table 1 in this publication is $1,980. Because you are a nonresident alien, you figure the limited taxable amount of your annuity as follows.

Worksheet for Nonresident Alien

1. Enter the otherwise taxable amount of the CSRS or FERS annuity (from line 9 of Table 1) or TSP distributions . . .	$ 1,980
2. Enter the total U.S. Government basic pay other than tax-exempt pay for services performed outside the United States	40,000
3. Enter the total U.S. Government basic pay for all services	120,000
4. Divide line 2 by line 3	.333
5. **Limited taxable amount.** Multiply line 1 by the number on line 4. Enter this amount on Form 1040NR, line 17b . .	$ 659

Thrift Savings Plan

All of the money in your Thrift Savings Plan (TSP) account is taxed as ordinary income when you receive it. This is because neither the contributions to your TSP account nor its earnings have been previously included in your taxable income. The way that you withdraw your account balance determines when you must pay the tax.

Direct rollover by the TSP. If you ask the TSP to transfer any part of the money in your account to a traditional IRA or other qualified retirement plan, the tax on that part is deferred until you receive payments from the traditional IRA or other plan. See *Rollover Rules,* later.

TSP annuity. If you ask the TSP to buy an annuity with the money in your account, the annuity payments are taxed when you receive them. The payments are ***not*** subject to the additional 10% tax on early distributions, even if you are under age 55 when they begin.

Cash withdrawals. If you withdraw any of the money in your TSP account, it is taxed as ordinary income when you receive it unless you roll it over into a traditional IRA or other qualified plan. (See *Rollover Rules,* later.) If you receive your entire TSP account balance in a single tax year, you may be able to use the 10-year tax option to figure your tax. See *Lump-Sum Distributions* in Publication 575 for details.

If you receive a single payment or you choose to receive your account balance in monthly payments over a period of less than 10 years, the TSP generally must withhold 20% for federal income tax. If you choose to receive your account balance in monthly payments over a period of 10 or more years or a period based on your life expectancy, the payments are subject to withholding under the same rules as your CSRS or FERS annuity. See *Tax Withholding and Estimated Tax* in Part I.

Tax on early distributions. Any money paid to you from your TSP account before you reach age 59½ may be subject to an additional 10% tax on early distributions. However, this additional tax does not apply in any of the following situations.

1) You separate from government service during or after the calendar year in which you reach age 55.
2) You choose to receive your account balance in monthly payments based on your life expectancy.
3) You retire on disability.

For more information, see *Tax on Early Distributions* in Publication 575.

Outstanding loan. If the TSP declares a distribution from your account because money you borrowed has not been repaid when you separate from government service, your account is reduced and the amount of the distribution (your unpaid loan balance and any unpaid interest) is taxed in the year declared. The distribution also may be subject to the additional 10% tax on early distributions. However, the tax will be deferred if you make a rollover contribution to a traditional IRA or other qualified plan equal to the declared distribution amount. See *Rollover Rules,* next. If you withdraw any money from your TSP account the same year, the TSP must withhold income tax of 20% of the total of the declared distribution and the amount withdrawn.

More information. For more information about the TSP, see *Summary of the Thrift Savings Plan for Federal Employees,* distributed to all federal employees. Also see *Important Tax Information About Payments From Your TSP Account* and *Tax Treatment of Thrift Savings Plan Payments to Nonresident Aliens and Their Beneficiaries,* which are available from your agency personnel office or from the TSP.

The above documents are also available on the Internet at **www.tsp.gov**. Select "Forms & Publications."

Rollover Rules

A rollover is a tax-free withdrawal of cash or other assets from one qualified retirement plan or traditional IRA and its reinvestment in another qualified retirement plan or traditional IRA. Do not include the amount rolled over in your income, and you cannot take a deduction for it. The amount rolled over is taxed later as the new program pays that amount to you. If you roll over amounts into a traditional IRA, later distributions of these amounts from the traditional IRA do not qualify for the capital gain or the 10-year tax option. However, capital gain treatment or the 10-year tax option will be restored if the traditional IRA contains only amounts rolled over from a qualified plan and these amounts are rolled over from the traditional IRA into a qualified retirement plan.

Qualified retirement plan. For this purpose, a qualified retirement plan generally is:

- A qualified employee plan, or
- A qualified employee annuity.

The CSRS, FERS, and TSP are considered qualified retirement plans.

TIP

For distributions made after 2001, the following plans will also be qualified retirement plans.

- *A tax-sheltered annuity plan (403(b) plan).*
- *An eligible state or local government section 457 deferred compensation plan.*

Distributions eligible for rollover treatment. If you receive a refund of your CSRS or FERS contributions when you leave government service, you can roll over any interest you receive on the contributions. You cannot roll over any part of your CSRS or FERS annuity payments.

You can roll over a distribution of any part of your TSP account balance ***except:***

1) A distribution of your account balance that you choose to receive in monthly payments over:
   a) Your life expectancy, or
   b) A period of 10 years or more,
2) A required minimum distribution generally beginning at age 70½,
3) A declared distribution because of an unrepaid loan, if you have not separated from government service (see *Outstanding loan* under *Thrift Savings Plan,* earlier), or
4) A hardship distribution.

In addition, a distribution to your beneficiary generally is not treated as an eligible rollover distribution. However, see *Qualified domestic relations order* and *Rollover by surviving spouse,* later.

Direct rollover option. You can choose to have the OPM or TSP transfer any part of an eligible rollover distribution directly to another qualified retirement plan that accepts rollover distributions or to a traditional IRA. The distribution cannot be rolled over into a Roth IRA.

No tax withheld. If you choose the direct rollover option, no tax will be withheld from any part of the distribution that is directly paid to the trustee of the other plan.

Payment to you option. If an eligible rollover distribution is paid to you, the OPM or TSP must withhold 20% for income tax even if you plan to roll over the distribution to another qualified retirement plan or traditional IRA. However, the full amount is treated as distributed to you even though you actually receive only 80%. You generally must include in income any part (including the part withheld) that you do not roll over within 60 days to another qualified retirement plan or to a traditional IRA.

If you leave government service before the calendar year in which you reach age 55 and are under age 59½ when a distribution is paid to you, you may have to pay an additional 10% tax on any part, including any tax withheld, that you do not roll over. See *Tax on Early Distributions* in Publication 575.

Exception to withholding. Withholding from an eligible rollover distribution paid to you is not required if the distributions for your tax year total less than $200.

Partial rollovers. If you receive a lump-sum distribution, it may qualify for capital gain treatment or the 10-year tax option. See *Lump-Sum Distributions* in Publication 575. However, if you roll over any part of the distribution, the part you keep does ***not*** qualify for this special tax treatment.

Rolling over more than amount received. If you want to roll over more of an eligible rollover distribution than the amount you received after income tax was withheld, you will have to add funds from some other source (such as your savings or borrowed amounts).

Example. You left government service at age 53. On February 1, 2002, you receive an eligible rollover distribution of $10,000 from your TSP account. The TSP withholds $2,000, so you actually receive $8,000. If you want to roll over the entire $10,000 to postpone including that amount in your income, you will have to get $2,000 from some other source and add it to the $8,000 you actually received.

If you roll over only $8,000, you must include in your income the $2,000 not rolled over. Also, you may be subject to the 10% additional tax on the $2,000.

Time for making rollover. You generally must complete the rollover of an eligible rollover distribution by the 60th day following the day on which you receive the distribution.

TIP *The 60-day period may be extended for distributions made after 2001 in certain cases of casualty, disaster, or other events beyond your reasonable control.*

Frozen deposits. If an amount distributed to you becomes a frozen deposit in a financial institution during the 60-day period after you receive it, the rollover period is extended. An amount is a frozen deposit if you cannot withdraw it because of either:

- The bankruptcy or insolvency of the financial institution, or
- Any requirement imposed by the state in which the institution is located because of the bankruptcy or insolvency (or threat of it) of one or more financial institutions in the state.

The 60-day rollover period is extended by the period for which the amount is a frozen deposit and does not end earlier than 10 days after the amount is no longer a frozen deposit.

Qualified domestic relations order. You may be able to roll over tax free all or part of a distribution you receive from the CSRS, the FERS, or the TSP under a court order in a divorce or similar proceeding. You must receive the distribution as the government employee's spouse or former spouse (not as a nonspousal beneficiary). The rollover rules apply to you as if you were the employee. You can roll over the distribution if it is an eligible rollover distribution (described earlier) and it is made under a qualified domestic relations order (QDRO) or, for the TSP, a qualifying order.

A QDRO is a judgment, decree, or order relating to payment of child support, alimony, or marital property rights. The payments must be made to a spouse, former spouse, child, or other dependent of a participant in the plan. For the TSP, a QDRO can be a qualifying order, but a domestic relations order can be a qualifying order even if it is not a QDRO. For example, a qualifying order can include an order that requires a TSP payment of attorney's fees to the attorney for the spouse, former spouse, or child of the participant.

The order must contain certain information, including the amount or percentage of the participant's benefits to be paid to each payee. It cannot require the plan to pay benefits in a form not offered by the plan, nor can it require the plan to pay increased benefits.

A distribution that is paid to a child, dependent, or, if applicable, an attorney for fees, under a QDRO or a qualifying order is taxed to the plan participant.

Rollover by surviving spouse. You may be able to roll over tax free all or part of the CSRS, FERS, or TSP distribution you receive as the surviving spouse of a deceased employee. The rollover rules apply to you as if you were the employee, except that you generally can roll over the distribution only into a traditional IRA.

TIP *You can roll over a distribution made after 2001 into a qualified retirement plan or a traditional IRA.*

A distribution paid to a beneficiary other than the employee's surviving spouse is not an eligible rollover distribution.

How to report. On your Form 1040, report the total distributions from the CSRS, FERS, or TSP on line 16a. Report the taxable amount of the distributions minus the amount rolled over, regardless of how the rollover was made, on line 16b. If you file Form 1040A, report the total distributions on line 12a and the taxable amount minus the amount rolled over on line 12b.

Written explanation to recipients. The TSP or OPM must provide a written explanation to you within a reasonable period of time before making an eligible rollover distribution to you. It must tell you about all of the following.

1) Your right to have the distribution paid tax free directly to another qualified retirement plan or to a traditional IRA.
2) The requirement to withhold tax from the distribution if it is not directly rolled over.
3) The nontaxability of any part of the distribution that you roll over within 60 days after you receive the distribution.
4) Other qualified retirement plan rules that apply, including those for lump-sum distributions, alternate payees, and cash or deferred arrangements.

TIP *For most distributions made after 2001, the explanation must also tell you how distributions from the plan receiving the rollover may be subject to restrictions and tax consequences that differ from those that apply to distributions from the plan making the rollover.*

Reasonable period of time. The TSP or OPM must provide you with a written explanation no earlier than 90 days and no later than 30 days before the distribution is made. However, you can choose to have the TSP or OPM make a distribution less than 30 days after the explanation is provided, as long as the following two requirements are met.

- You must have the opportunity to consider whether or not you want to make a direct rollover for at least 30 days after the explanation is provided.
- The information you receive must clearly state that you have the right to have 30 days to make a decision.

Contact the TSP or OPM if you have any questions about this information.

Choosing the right option. The following comparison chart may help you decide which distribution option to choose. Carefully compare the tax effects of each and choose the option that is best for you.

Comparison Chart

Direct Rollover	Payment to you
No withholding.	Payer generally must withhold income tax of 20% on the taxable part even if you roll it over.
No 10% additional tax.	If you are under age 59½, a 10% additional tax may apply to the taxable part, including the tax withheld, that you do not roll over.
Not income until later distributed to you from the other plan or the traditional IRA.	Taxable part, including the tax withheld, is income to the extent not rolled over.
If rolled over to another qualified plan, may be eligible for capital gain treatment or the 10-year tax option when later distributed to you from that plan.	May be eligible for capital gain treatment or the 10-year tax option if no part is rolled over.

How To Report Benefits

If you received annuity benefits that are not fully taxable, report the total received for the year on Form 1040, line 16a, or on Form 1040A, line 12a. Also include on that line the total of any other pension plan payments (even if fully taxable, such as those from the TSP) that you received during the year in addition to the annuity. Report the taxable amount of these total benefits on line 16b (Form 1040) or line 12b (Form 1040A). If you use Form 4972, *Tax on Lump-Sum Distributions,* however, to report the tax on any amount, do not include that amount on lines 16a and 16b or lines 12a and 12b; follow the Form 4972 instructions.

If you received only fully taxable payments from your retirement, the TSP, or other pension plan, report on Form 1040, line 16b, or Form 1040A, line 12b, the total received for the year (except for any amount reported on Form 4972); no entry is required on line 16a (Form 1040) or line 12a (Form 1040A).

Part III Rules for Disability Retirement and Credit for the Elderly or the Disabled

This part of the publication is for federal employees and retirees who receive disability benefits under the CSRS, the FERS, or other federal programs. It also explains the tax credit available to certain taxpayers because of age or disability.

Disability Annuity

If you retired on disability, the disability annuity you receive from the CSRS or FERS is taxable as wages until you reach ***minimum retirement age.*** Beginning on the day after you reach minimum retirement age, your payments are treated as a retirement annuity. At that time or at any time thereafter, you can begin to recover the cost of your annuity under the rules discussed in Part II.

If you find that you could have started your recovery in an earlier year for which you have already filed a return, you can start your recovery of contributions in that earlier year by filing an amended return for that year and each succeeding year. Generally, an amended return for any year must be filed within 3 years after the due date for filing your original return for that year.

Minimum retirement age. This is the age at which you could first receive an annuity were you not disabled. This generally is based on your age and length of service.

Retirement under the Civil Service Retirement System (CSRS). In most cases, under the CSRS, the minimum combinations of age and service for retirement are:

- Age 55 with 30 years of service,
- Age 60 with 20 years of service,
- Age 62 with 5 years of service, or
- For law enforcement, firefighter, or air traffic controller service, age 50 with 20 years of covered service.

Retirement under the Federal Employees Retirement System (FERS). In most cases, the minimum age for retirement under the FERS is between ages 55 and 57 with at least 10 years of service. With at least 5 years of service, your minimum retirement age cannot be older than age 62. Your minimum retirement age (MRA) with at least 10 years of service is shown in the following table.

If you were born in	Your MRA is
1947 or earlier	55 years
1948	55 years, 2 months
1949	55 years, 4 months
1950	55 years, 6 months
1951	55 years, 8 months
1952	55 years, 10 months
1953 to 1964	56 years
1965	56 years, 2 months
1966	56 years, 4 months
1967	56 years, 6 months
1968	56 years, 8 months
1969	56 years, 10 months
1970 or later	57 years

Your minimum retirement age with law enforcement, firefighter, or air traffic controller service is age 50 with 20 years of covered service or any age with 25 years of covered service.

How to report. You must report all your disability annuity payments received before minimum retirement age on line 7 (Form 1040 or Form 1040A).

Withholding. For income tax withholding purposes, a disability annuity is treated the same as a nondisability annuity. This treatment also applies to disability payments received before minimum retirement age when these payments are shown as wages on your return. See *Tax Withholding and Estimated Tax* in *Part I,* earlier.

Other Benefits

The tax treatment of certain other benefits is explained in this section.

Federal Employees' Compensation Act (FECA). FECA payments you receive for personal injuries or sickness resulting from the performance of your duties are like workers' compensation. They are tax exempt and are not treated as disability income or annuities. However, payments you receive while your claim is being processed, including pay while on sick leave and continuation of pay for up to 45 days, are taxable.

Sick pay or disability payments repaid. If you repay sick leave or disability annuity payments you received in an earlier year to be eligible for nontaxable FECA benefits, you can deduct the amount you repay. You can claim the deduction whether you repay the amount yourself or have the FECA payment sent directly to your employing agency or the OPM.

Claim the deduction on Schedule A (Form 1040) as a miscellaneous itemized deduction, subject to the 2%-of-adjusted-gross-income limit. It is considered a business loss and may create a net operating loss if your deductions for the year are more than your income for the year. Get Publication 536, *Net Operating Losses (NOLs) for Individuals, Estates, and Trusts,* for more information. The repayment is not eligible for the special tax credit that applies to repayments over $3,000 of amounts received under a claim of right.

If you repay sick leave or disability annuity payments in the same year you receive them, the repayment reduces the taxable sick pay or disability annuity you include in income. Do not deduct it separately.

Terrorist attack. Disability benefits you receive for injuries resulting from a violent attack are tax exempt and are not treated as disability income or annuities if:

1) The attack took place while you were a federal employee performing official duties outside the United States, and
2) The Secretary of State determines it to have been a terrorist attack.

CAUTION

As this publication was being prepared for print, Congress was considering legislation that would exempt from tax disability benefits received by any individual for injuries resulting from a terrorist or military action inside or outside the United States. For more information, see Publication 3920.

Disability resulting from military service injuries. If you received tax-exempt benefits from the Department of Veterans Affairs for personal injuries resulting from active service in the armed forces and later receive a CSRS or FERS disability annuity for disability arising from the same injuries, you cannot treat the disability annuity payments as tax-exempt income. They are subject to the rules described earlier under *Disability Annuity.*

Payment for unused annual leave. When you retire, any payment for your unused annual leave is taxed as wages in the tax year you receive the payment.

Credit for the Elderly or the Disabled

You can take the credit for the elderly or the disabled if:

- You are a ***qualified individual***, and
- Your income is not more than certain limits.

You are a qualified individual for this credit if you are a U.S. citizen or resident and, at the end of the tax year, you are:

1) Age 65 or older, or
2) Under age 65, retired on permanent and total disability, and
   a) Received taxable disability income, and
   b) Did not reach ***mandatory retirement age*** (defined later) before the tax year.

You are retired on permanent and total disability if:

1) You were permanently and totally disabled when you retired, and
2) You retired on disability before the close of the tax year.

Even if you do not retire formally, you are considered retired on disability when you have stopped working because of your disability.

Permanently and totally disabled. You are permanently and totally disabled if you cannot engage in any substantial gainful activity because of your physical or mental condition. A physician must certify that your condition is expected to result in death or has lasted, or can be expected to last, continuously for 12 months or more. ***Substantial gainful activity*** is the performance of significant duties over a reasonable period of time while working for pay or profit, or in work generally done for pay or profit.

Mandatory retirement age. This is the age set by your employer at which you would have had to retire if you had not become disabled. There is no mandatory retirement age for most federal employees. However, there is a mandatory retirement age for the following employees.

- An air traffic controller appointed after May 15, 1972, by the Department of Transportation or the Department of Defense generally must retire by the last day of the month in which he or she reaches age 56.
- A firefighter employed by the U.S. Government who is otherwise eligible for immediate retirement generally must retire by the last day of the month in which he or she reaches age 57 or, if later, completes 20 years of firefighter service.
- A law enforcement officer employed by the U.S. Government who is otherwise eligible for immediate retirement generally must retire by the last day of the month in which he or she reaches age 57 or, if later, completes 20 years of law enforcement service.

Physician's statement. If you are under 65, you must have your physician complete a statement certifying that you are permanently and totally disabled on the date you retired. You must keep this statement for your tax records. You can use the *Physician's Statement* in the instructions for either Schedule R (Form 1040) or Schedule 3 (Form 1040A).

Figuring the credit. If you figure the credit yourself, fill out the front of either Schedule R (if you are filing Form 1040) or Schedule 3 (if you are filing Form 1040A). Next fill out Part III of either Schedule R or Schedule 3.

If you want the Internal Revenue Service to figure your tax and credits, including the credit for the elderly or the disabled, see Publication 967, *The IRS Will Figure Your Tax,* and the instructions for Schedule R (Form 1040) or Schedule 3 (Form 1040A).

More information. For detailed information about this credit, get Publication 524.

Part IV Rules for Survivors of Federal Employees

This part of the publication is for survivors of federal employees. It explains how to treat amounts you receive because of the employee's death. If you are the survivor of a federal retiree, see Part V.

Employee earnings. Salary or wages earned by a federal employee but paid to the employee's survivor or beneficiary after the employee's death are ***income in respect of the decedent***. This income is taxable to the survivor or beneficiary. This treatment also applies to payments for accrued annual leave.

Dependents of public safety officers. The Public Safety Officers' Benefits program, administered through the Bureau of Justice Assistance, provides a tax-free death benefit to eligible survivors of public safety officers whose death is the direct and proximate result of a traumatic injury sustained in the line of duty. The death benefit is not includible in the decedent's gross estate for federal estate tax purposes or the survivor's gross income for federal income tax purposes.

A public safety officer is a law enforcement officer, firefighter, or member of a public rescue squad or ambulance crew.

This program may pay survivors a temporary benefit up to $3,000 if it finds that the death of the public safety officer is one for which a final benefit will probably be paid. If there is no final payment, the recipient of the temporary benefit is liable for repayment. However, the Bureau may not require all or part of the repayment if it will cause a hardship. If that happens, that amount is tax free.

For more information on this program, you may contact the Bureau of Justice Assistance by calling **1–888–744–6513,** or **202–307–0635** if you are in the metropolitan Washington, D.C., calling area.

Additional information about this death benefit is also available on the Internet at **www.ojp.usdoj.gov/BJA**. Select "Funding" then select "Benefits."

FERS Death Benefit

You may be entitled to a special FERS death benefit if you were the spouse of an active FERS employee who died after at least 18 months of federal service. At your option, you can take the benefit in the form of a single payment or in the form of a special annuity payable over a 3-year period.

The tax treatment of the special death benefit depends on the option you choose and whether a FERS survivor annuity is also paid.

If you choose the ***single payment option,*** use the following rules.

- If a FERS survivor annuity is not paid, at least part of the special death benefit is tax free. The tax-free part is an amount equal to the employee's FERS contributions.
- If a FERS survivor annuity is paid, all of the special death benefit is taxable. You cannot allocate any of the employee's FERS contributions to the special death benefit.

If you choose the ***3-year annuity option,*** at least part of each monthly payment is tax free. Use the following rules.

- If a FERS survivor annuity is not paid, the tax-free part of each monthly payment is an amount equal to the employee's FERS contributions divided by 36.
- If a FERS survivor annuity is paid, allocate the employee's FERS contributions between the 3-year annuity and the survivor annuity. Make the allocation in the same proportion that the expected return from each annuity bears to the total expected return from both annuities. Divide the amount allocated to the 3-year annuity by 36. The result is the tax-free part of each monthly payment of the 3-year annuity.

CSRS or FERS Survivor Annuity

If you receive a CSRS or FERS survivor annuity, you can recover the employee's cost tax free. The employee's cost is the total of the retirement plan contributions that were taken out of his or her pay.

How you figure the tax-free recovery of the cost depends on your ***annuity starting date***. This is the day after the date of the employee's death. The methods to use are the same as those described near the beginning of *Part II* under *Recovering your cost tax free.*

The following discussions cover only the Simplified Method. You can use this method if your annuity starting date is after July 1, 1986. You ***must*** use this method if your annuity starting date is after November 18, 1996. Under the Simplified Method, each of your monthly annuity payments is made up of two parts: the tax-free part that is a return of the employee's cost and the taxable part that is the amount of each payment that is more than the part that represents the employee's cost. The tax-free part remains the same, even if your annuity is increased. However, see *Exclusion limit*, later.

Surviving spouse with no children receiving annuities. Under the Simplified Method, you figure the tax-free part of each full monthly annuity payment by dividing the employee's cost by a number of months based on your age. This number will differ depending on whether your annuity starting date is on or before November 18, 1996, or later. To use the Simplified Method, complete the worksheet in Table 1, near the end of this publication. Specific instructions for Table 1 are given in *Part II* under *Simplified Method*.

Example. Diane Greene, age 48, began receiving a $1,500 monthly CSRS annuity in March 2001 upon the death of her husband. Her husband was a federal employee when he died. She received 10 payments in 2001. Her husband had contributed $36,000 to the retirement plan.

Diane must use the Simplified Method. Her completed worksheet (Table 1) is shown on the next page. To complete line 3, she used Table 1 at the bottom of the worksheet and found the number in the last column opposite the age range that includes her age. Diane keeps a copy of the completed worksheet for her records. It will help her figure her taxable annuity in later years.

Diane's tax-free monthly amount is $100 (line 4 of her worksheet). If she lives to collect more than 360 payments, the payments after the 360th will be fully taxable. If she dies before 360 payments have been made, a miscellaneous itemized deduction (not subject to the 2%-of-adjusted-gross-income limit) will be allowed for the unrecovered cost on her final income tax return.

Surviving spouse with child. If the survivor benefits include both a life annuity for the surviving spouse and one or more temporary annuities for the employee's children, an additional step is needed under the Simplified Method to allocate the monthly exclusion among the beneficiaries correctly.

Figure the total monthly exclusion for all beneficiaries by completing lines 2 through 4 of the worksheet in Table 1 as if only the surviving spouse received an annuity. Then, to figure the monthly exclusion for each beneficiary, multiply line 4 of the worksheet by a fraction. For any beneficiary, the numerator of the fraction is that beneficiary's monthly annuity and the denominator of the fraction is the total of the monthly annuity payments to all the beneficiaries.

The ending of a child's temporary annuity does not affect the total monthly exclusion figured under the Simpli-

Filled-In Table 1 for Diane Greene Example

Table 1. **Simplified Method Worksheet** (Keep For Your Records)

See the instructions for the worksheet in Part II under *Simplified Method.*

1.	Enter the total annuity received this year. Also add this amount to the total for Form 1040, line 16a, or Form 1040A, line 12a . . .	$ 15,000
2.	Enter your cost in the plan at the annuity starting date, plus any death benefit exclusion	36,000
	NOTE: *If your annuity starting date was* ***before this year*** *and you completed this worksheet last year, skip line 3 and enter the amount from line 4 of last year's worksheet on line 4 below. Otherwise, go to line 3.*	
3.	Enter the appropriate number from Table 1 below. **But** if your annuity starting date was **after** 1997 **and** the payments are for your life and that of your beneficiary, enter the appropriate number from Table 2 below . . .	360
4.	Divide line 2 by line 3 . . .	100
5.	Multiply line 4 by the number of months for which this year's payments were made. If your annuity starting date was before 1987, enter this amount on line 8 below and skip lines 6, 7, 10, and 11. Otherwise go to line 6 . . .	$ 1,000
6.	Enter any amounts previously recovered tax free in years after 1986 . . .	0
7.	Subtract line 6 from line 2 . . .	36,000
8.	Enter the smaller of line 5 or line 7 . . .	1,000
9.	**Taxable annuity for year.** Subtract line 8 from line 1. Enter the result, but not less than zero. Also add this amount to the total for Form 1040, line 16b, or Form 1040A, line 12b. If your Form CSA 1099R or Form CSF 1099R shows a larger amount, use the amount on this line instead . . .	$ 14,000
10.	Add lines 6 and 8 . . .	1,000
11.	**Balance of cost to be recovered.** Subtract line 10 from line 2 . . .	$ 35,000

Table 1 for Line 3 Above

IF the age at annuity starting date was. . .	AND your annuity starting date was— **before** November 19, 1996, enter on line 3. . .	**after** November 18, 1996, enter on line 3. . .
55 or under	300	360
56–60	260	310
61–65	240	260
66–70	170	210
71 or older	120	160

Table 2 for Line 3 Above

IF the combined ages at annuity starting date were. . .	THEN enter on line 3. . .
110 and under	410
111–120	360
121–130	310
131–140	260
141 or older	210

fied Method. The total exclusion merely needs to be reallocated at that time among the remaining beneficiaries. If only the surviving spouse is left drawing an annuity, the surviving spouse is entitled to the entire monthly exclusion as figured in the worksheet.

Example. The facts are the same as in the example for Diane Greene in the preceding discussion except that the Greenes had a son, Robert, who was age 15 at the time of his father's death. Robert is entitled to a $500 per month temporary annuity until he reaches age 18 (age 22, if he remains a full-time student and does not marry).

In completing the Table 1 worksheet (not shown), Diane fills out the entries through line 4 exactly as shown in the filled-in Table 1 worksheet for the earlier example. That is, she includes on line 1 only the amount of the annuity she herself received and she uses on line 3 the 360 factor for her age. After arriving at the $100 monthly exclusion on line 4, however, Diane allocates it between her own annuity and that of her son.

To find how much of the monthly exclusion to allocate to her own annuity, Diane multiplies the $100 monthly exclusion by the fraction $1,500 (her monthly annuity) over $2,000 (the total of her $1,500 and Robert's $500 annuities). She enters the result, $75, just below the entry space for line 4. She completes the worksheet by entering $750 on lines 5 and 8 and $14,250 on line 9.

A second worksheet (not shown) is completed for Robert's annuity. On line 1, he enters $5,000 as the total annuity received. Lines 2, 3, and 4 are the same as those on his mother's worksheet. In allocating the $100 monthly exclusion on line 4 to his annuity, Robert multiplies it by the fraction $500 over $2,000. His resulting monthly exclusion is $25. His exclusion for the year (line 8) is $250 and his taxable annuity for the year (line 9) is $4,750.

Diane and Robert only need to complete lines 10 and 11 on a single worksheet to keep track of their unrecovered cost for next year. These lines are exactly as shown in the filled-in Table 1 worksheet for the earlier example.

When Robert's temporary annuity ends, the computation of the total monthly exclusion will not change. The only difference will be that Diane will then claim the full exclusion against her annuity alone.

Surviving child only. A method similar to the Simplified Method also can be used to figure the taxable and nontaxable parts of a temporary annuity for a surviving child when there is no surviving spouse annuity. To use this method, divide the deceased employee's cost by the number of months from the child's annuity starting date until the date the child will reach age 22. The result is the monthly exclusion. (But the monthly exclusion cannot be more than the monthly annuity payment. You can carry over unused exclusion amounts to apply against future annuity payments.)

More than one child. If there is more than one child entitled to a temporary annuity (and no surviving spouse annuity), divide the cost by the number of months of payments until the date the ***youngest*** child will reach age 22. This monthly exclusion must then be allocated among the children in proportion to their monthly annuity payments, like the exclusion shown in the previous example.

Disabled child. If a child otherwise entitled to a temporary annuity was permanently disabled at the annuity starting date (and there is no surviving spouse annuity), that child is treated for tax purposes as receiving a lifetime annuity, like a surviving spouse. The child must complete line 3 of the Simplified Method Worksheet using a number in Table 1 at the bottom of the worksheet corresponding to the child's age at the annuity starting date. If more than one child is entitled to a temporary annuity, an allocation like the one shown under *Surviving spouse with child,* earlier, must be made to determine each child's share of the exclusion.

Exclusion limit. If your annuity starting date is after 1986, the most that can be recovered tax free is the cost of the annuity. Once the total of your exclusions equals the cost, your entire annuity is taxable. If your annuity starting date is before 1987, the tax-free part of each whole monthly payment remains the same each year you receive payments—even if you outlive the number of months used on line 3 of the Simplified Method Worksheet. The total exclusion may be more than the cost of the annuity.

Deduction of unrecovered cost. If the annuity starting date is after July 1, 1986, and the annuitant's death occurs before all the cost is recovered tax free, the unrecovered cost can be claimed as a miscellaneous itemized deduction (not subject to the 2%-of-adjusted-gross-income limit) for the annuitant's last tax year.

Survivors of Slain Public Safety Officers

Generally, if you receive a survivor annuity as the spouse, former spouse, or child of a public safety officer killed in the line of duty after 1996, you can exclude it from your income. The annuity is excludable to the extent that it is due to the officer's service as a public safety officer. Public safety officers include police and law enforcement officers, fire fighters, ambulance crews, and rescue squads.

TIP *Survivor annuity payments received after 2001 by the spouse, former spouse, or child of a public safety officer killed in the line of duty before 1997 can also be excluded from income.*

The exclusion does not apply if your actions were a substantial contributing factor to the death of the officer. It also does not apply if:

- The death was caused by the intentional misconduct of the officer or by the officer's intention to cause his or her own death,
- The officer was voluntarily intoxicated at the time of death, or
- The officer was performing his or her duties in a grossly negligent manner at the time of death.

The special death benefit paid to the spouse of a FERS employee (see FERS Death Benefit*, earlier) is not eligible for this exclusion.*

Lump-Sum CSRS or FERS Payment

If a federal employee dies before retiring and leaves no one eligible for a survivor annuity, the estate or other beneficiary will receive a lump-sum payment from the CSRS or FERS. This single payment is made up of the regular contributions to the retirement fund plus accrued interest, if any, to the extent not already paid to the employee.

The beneficiary is taxed, in the year the lump sum is distributed or made available, only on the amount of any accrued interest. The taxable amount, if any, generally cannot be rolled over into an IRA or other plan and is subject to federal income tax withholding at a 10% rate. It may qualify as a lump-sum distribution eligible for capital gain treatment or the 10-year tax option. If the beneficiary also receives a lump-sum payment of unrecovered voluntary contributions plus interest, this treatment applies only if the payment is received within the same tax year. For more information, see *Lump-Sum Distributions* in Publication 575.

Lump-sum payment at end of survivor annuity. If an annuity is paid to the federal employee's survivor and the survivor annuity ends before an amount equal to the deceased employee's contributions plus any interest has been paid out, the rest of the contributions plus any interest will be paid in a lump sum to the employee's estate or other beneficiary. Generally, this beneficiary will not have to include any of the lump sum in gross income because, when it is added to the amount of the annuity previously received that was excludable, it still will be less than the employee's total contributions.

To figure the taxable amount, if any, use the following worksheet.

Lump-Sum Payment at End of Survivor Annuity

1. Enter the lump-sum payment	$
2. Enter the amount of annuity previously received tax-free	
3. Add lines 1 and 2	
4. Enter the employee's total cost . . .	
5. **Taxable amount.** Subtract line 4 from line 3. Enter the result, but not less than zero	

The taxable amount, if any, generally cannot be rolled over into an IRA or other plan and is subject to federal income tax withholding at a 10% rate. It may qualify as a lump-sum distribution eligible for capital gain treatment or the 10-year tax option. If the beneficiary also receives a lump-sum payment of unrecovered voluntary contributions plus interest, this treatment applies only if the payment is received within the same tax year. For more information, see *Lump-Sum Distributions* in Publication 575.

Example. At the time of your brother's death in December 2000, he was employed by the federal government and had contributed $45,000 to the CSRS. His widow received $6,600 in survivor annuity payments before she died in 2001. She had used the Simplified Method for reporting her annuity and properly excluded $1,000 from gross income.

Since only $6,600 of the guaranteed amount of $45,000 (your brother's contributions) was paid as an annuity, the balance of $38,400 was paid to you in a lump sum as your brother's sole beneficiary. You figure the taxable amount of this payment as follows.

Lump-Sum Payment at End of Survivor Annuity

1. Enter the lump-sum payment	*$38,400*
2. Enter the amount of annuity previously received tax free	*1,000*
3. Add lines 1 and 2	*39,400*
4. Enter the employee's total cost	*45,000*
5. **Taxable amount.** Subtract line 4 from line 3. Enter the result, but not less than zero	*0*

Voluntary contributions. If a CSRS employee dies before retiring from government service, any voluntary contributions to the retirement fund cannot be used to provide an additional annuity to the survivors. Instead, the voluntary contributions plus any accrued interest will be paid in a lump sum to the estate or other beneficiary. The beneficiary must generally include any interest received in income for the year distributed or made available. However, if the beneficiary is the employee's surviving spouse, the interest can be rolled over. See *Rollover by surviving spouse* under *Rollover Rules* in *Part II*.

The interest, if not rolled over, is generally subject to federal income tax withholding at a 20% rate (or 10% rate if the beneficiary is not the employee's surviving spouse). It may qualify as a lump-sum distribution eligible for capital gain treatment or the 10-year tax option if:

- Regular annuity benefits cannot be paid under the system, and
- The beneficiary also receives a lump-sum payment of the regular contributions plus interest within the same tax year as the voluntary contributions.

For more information, see *Lump-Sum Distributions* in Publication 575.

Thrift Savings Plan

The payment you receive as the beneficiary of a decedent's Thrift Savings Plan (TSP) account is fully taxable. However, if you are the decedent's surviving spouse, you generally can roll over the payment tax free. If you do not choose a direct rollover of the decedent's TSP account, mandatory 20% income tax withholding will apply. For more information, see *Rollover Rules* in *Part II*. If you are not the surviving spouse, the payment is not eligible for rollover treatment. The TSP will withhold 10% of the payment for federal income tax, unless you give the TSP a Form W−4P to choose not to have tax withheld.

If the entire TSP account balance is paid to the beneficiaries in the same calendar year, it may qualify as a lump-sum distribution eligible for the 10-year tax option. See *Lump-Sum Distributions* in Publication 575 for details. Also see *Important Tax Information About Thrift Savings Plan Death Benefit Payments,* which is available from the TSP.

The above TSP document is also available on the Internet at **www.tsp.gov**. Select “Forms & Publications” and then select “Other Documents.”

Federal Estate Tax

Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return,* must be filed for the estate of a citizen or resident of the United States who died in 2001 if the gross estate is more than $675,000. Included in this $675,000 are any taxable gifts made by the decedent after 1976 and the specific exemption allowed for gifts by the decedent after September 8, 1976, and before 1977.

The gross estate generally includes the value of all property beneficially owned by the decedent at the time of death. Examples of property included in the gross estate are salary or annuity payments that had accrued to an employee or retiree, but which were not paid before death, and the balance in the decedent’s TSP account.

The gross estate usually also includes the value of the death and survivor benefits payable under the CSRS or the FERS. If the federal employee died leaving no one eligible to receive a survivor annuity, the lump sum (representing the employee’s contribution to the system plus any accrued interest) payable to the estate or other beneficiary is included in the employee’s gross estate.

Marital deduction. The estate tax marital deduction is a deduction from the gross estate of the value of property that is included in the gross estate but that passes, or has passed, to the surviving spouse. Generally, there is no limit on the amount of the marital deduction. Community property passing to the surviving spouse qualifies for the marital deduction.

More information. For more information, get Publication 950 and Publication 559, *Survivors, Executors, and Administrators*.

Part V Rules for Survivors of Federal Retirees

This part of the publication is for survivors of federal retirees. It explains how to treat amounts you receive because of the retiree’s death. If you are the survivor of a federal employee, see Part IV.

Decedent’s retirement benefits. Retirement benefits accrued and payable to a CSRS or FERS retiree before death, but paid to you as a survivor, are taxable in the same manner and to the same extent these benefits would have been taxable had the retiree lived to receive them.

CSRS or FERS Survivor Annuity

CSRS or FERS annuity payments you receive as the surviving spouse of a federal retiree are fully or partly taxable under either the General Rule or the Simplified Method.

Cost recovered. If the retiree reported the annuity under the Three-Year Rule and recovered all of the cost tax free before dying, your survivor annuity payments are fully taxable. This is also true if the retiree had an annuity starting date after 1986, reported the annuity under the General Rule or the Simplified Method, and had fully recovered the cost tax free.

General Rule. If the retiree was reporting the annuity under the General Rule, use the same exclusion percentage that the retiree used. Apply the exclusion percentage to the amount specified as your survivor annuity at the retiree’s annuity starting date. Do not apply the exclusion percentage to any cost-of-living increases made after that date. Those increases are fully taxable. For more information about the General Rule, get Publication 939.

Simplified Method. If the retiree was reporting the annuity under the Simplified Method, your tax-free monthly amount is the same as the retiree’s monthly exclusion (from line 4 of the Simplified Method Worksheet). This amount remains fixed even if the monthly payment is increased or decreased. A cost-of-living increase in your survivor annuity payments does not change the amount you can exclude from gross income.

Exclusion limit. If the retiree’s annuity starting date was before 1987, you can exclude the tax-free amount from all the annuity payments you receive. This includes any payments received after you recover the cost tax free.

If the retiree’s annuity starting date is after 1986, you can exclude the tax-free amount only until you recover the cost tax free. The annuity payments you receive after you recover the annuity cost tax free are fully taxable.

Deduction of unrecovered cost. If the annuity starting date is after July 1, 1986, and the survivor annuitant’s death occurs before all the cost is recovered tax free, the unrecovered cost can be claimed as a miscellaneous itemized deduction (not subject to the 2%-of-adjusted-gross-income limit) for the annuitant’s last tax year.

Surviving spouse with child. If the survivor benefits include both a life annuity for the surviving spouse and one or more temporary annuities for the retiree’s children, the tax-free monthly amount that would otherwise apply to the life annuity must be allocated among the beneficiaries. To figure the tax-free monthly amount for each beneficiary, multiply it by a fraction. The numerator of the fraction is the beneficiary’s monthly annuity and the denominator of the fraction is the total of the monthly annuity payments to all the beneficiaries.

Example. John retired in 1999 and began receiving a $1,147 per month CSRS retirement annuity with a survivor annuity payable to his wife, Kate, upon his death. He reported his annuity using the Simplified Method. Under that method, $150 of each payment he received was a tax-free recovery of his $45,000 cost. John received a total of 22 monthly payments and recovered $3,300 of his cost tax free before his death in 2001. At John's death, Kate began receiving an annuity of $840 per month and their children, Sam and Lou, began receiving temporary annuities of $330 each per month. Kate must allocate the $150 tax-free monthly amount among the three annuities.

Kate allocates $84 ($150 × $840/$1,500) of the tax-free monthly amount to her annuity and $33 ($150 × $330/ $1,500) to each child's annuity. Beginning the month in which either child is no longer eligible for an annuity, she will reallocate $108 ($150 × $840/$1,170) of the $150 tax-free monthly amount to her annuity and $42 ($150 × $330/$1,170) to the other child's annuity.

Surviving child only. If the survivor benefits include only a temporary annuity for the retiree's child, allocate the unrecovered cost over the number of months from the date the annuity started until the child reaches age 22. If more than one temporary annuity is paid, allocate the cost over the number of months until the ***youngest*** child reaches age 22, and allocate the tax-free monthly amount among the annuities in proportion to the monthly annuity payments.

Lump-Sum CSRS or FERS Payment

If a deceased retiree has no beneficiary eligible to receive a survivor annuity, and the deceased retiree's annuity ends before an amount equal to the deceased retiree's contributions plus any interest has been paid out, the rest of the contributions plus any interest will be paid in a lump sum to the estate or other beneficiary. The estate or other beneficiary will rarely have to include any part of the lump sum in gross income. The taxable amount is figured as follows.

Lump-Sum Payment to Estate or Other Beneficiary

1.	Enter the lump-sum payment	$______
2.	Enter the amount of annuity received tax-free by the retiree	______
3.	Add line 1 and line 2	______
4.	Enter the total cost	______
5.	**Taxable amount.** Subtract line 4 from line 3. Enter the result, but not less than zero	______

The taxable amount, if any, generally cannot be rolled over into an IRA or other plan and is subject to federal income tax withholding at a 10% rate. It may qualify as a lump-sum distribution eligible for capital gain treatment or the 10-year tax option. If the beneficiary also receives a lump-sum payment of unrecovered voluntary contributions plus interest, this treatment applies only if the payment is received within the same tax year. For more information, see *Lump-Sum Distributions* in Publication 575.

Voluntary Contributions

If you receive an additional survivor annuity benefit from voluntary contributions to the CSRS, treat it separately from the annuity that comes from regular contributions. Each year you will receive Form CSF 1099R that will show how much of your total annuity received in the past year was from each type of benefit.

Figure the taxable and tax-free parts of your additional survivor annuity benefit from voluntary contributions using the same rules that apply to regular CSRS and FERS survivor annuities, as explained earlier under *CSRS or FERS Survivor Annuity.*

Lump-sum payment. Figure the taxable amount, if any, of a lump-sum payment of the retiree's unrecovered voluntary contributions plus any interest using the rules that apply to regular lump-sum CSRS or FERS payments, as explained earlier under *Lump-Sum CSRS or FERS Payment.*

Thrift Savings Plan

If you receive a payment from the TSP account of a deceased federal retiree, the payment is fully taxable. However, if you are the retiree's surviving spouse, you generally can roll over the otherwise taxable payment tax free. If you do not choose a direct rollover of the TSP account, mandatory 20% federal income tax withholding will apply. For more information, see *Rollover Rules* in *Part II,* earlier. If you are not the surviving spouse, the payment is not eligible for rollover treatment. The TSP will withhold 10% of the payment for federal income tax, unless you give the TSP a Form W−4P to choose not to have tax withheld.

If the retiree chose to receive his or her account balance as an annuity, the payments you receive as the retiree's survivor are fully taxable when you receive them, whether they are received as annuity payments or as a cash refund of the remaining value of the amount used to purchase the annuity.

Federal Estate Tax

A federal estate tax return may have to be filed for the estate of the retired employee. See *Federal Estate Tax* in *Part IV*.

Income Tax Deduction for Estate Tax Paid

Any income that a decedent had a right to receive and could have received had death not occurred and that was not properly includible in the decedent's final income tax return is treated as ***income in respect of a decedent.*** This includes retirement benefits accrued and payable to a retiree before death, but paid to you as a survivor.

If you are required to include income in respect of a decedent in gross income for any tax year, you can deduct for the same tax year the portion of the federal estate tax imposed on the decedent's estate that is from the inclusion in the estate of the right to receive that amount. For this purpose, if the decedent died after the annuity starting date, the taxable portion of a survivor annuity you receive (other than a temporary annuity for a child) is considered income in respect of a decedent.

The federal estate tax you can deduct is determined by comparing the actual federal estate tax and the tax that would have been paid if the income in respect of the decedent were not included in the gross estate.

Income tax deductions for the estate tax on the value of your survivor annuity will be spread over the period of your life expectancy. The deductions cannot be taken beyond your life expectancy. Moreover, if you should die before the end of this period, there is no compensating adjustment for the unused deductions.

If the income in respect of the decedent is ordinary income, the estate tax must be deducted as a miscellaneous itemized deduction (not subject to the 2%-of-adjusted-gross-income limit).

For more information, see *Income in Respect of the Decedent* in Publication 559.

How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get more information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

Contacting your Taxpayer Advocate. If you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate.

The Taxpayer Advocate represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

To contact your Taxpayer Advocate:

- Call the Taxpayer Advocate at **1–877–777–4778.**
- Call the IRS at **1–800–829–1040.**
- Call, write, or fax the Taxpayer Advocate office in your area.
- Call **1–800–829–4059** if you are a TTY/TDD user.

For more information, see Publication 1546, *The Taxpayer Advocate Service of the IRS.*

Free tax services. To find out what services are available, get Publication 910, *Guide to Free Tax Services.* It contains a list of free tax publications and an index of tax topics. It also describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.

Personal computer. With your personal computer and modem, you can access the IRS on the Internet at **www.irs.gov**. While visiting our web site, you can:

- Find answers to questions you may have.
- Download forms and publications or search for forms and publications by topic or keyword.
- View forms that may be filled in electronically, print the completed form, and then save the form for recordkeeping.
- View Internal Revenue Bulletins published in the last few years.
- Search regulations and the Internal Revenue Code.
- Receive our electronic newsletters on hot tax issues and news.
- Get information on starting and operating a small business.

You can also reach us with your computer using File Transfer Protocol at **ftp.irs.gov.**

TaxFax Service. Using the phone attached to your fax machine, you can receive forms and instructions by calling **703–368–9694.** Follow the directions from the prompts. When you order forms, enter the catalog number for the form you need. The items you request will be faxed to you.

For help with transmission problems, call the FedWorld Help Desk at **703–487–4608.**

Phone. Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call **1–800–829–3676** to order current and prior year forms, instructions, and publications.
- *Asking tax questions.* Call the IRS with your tax questions at **1–800–829–1040.**
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call **1–800–829–4059** to ask tax questions or to order forms and publications.
- *TeleTax topics.* Call **1–800–829–4477** to listen to pre-recorded messages covering various tax topics.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we evaluate the quality of our telephone services in several ways.

- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistor and does not keep a record of any taxpayer's name or tax identification number.
- We sometimes record telephone calls to evaluate IRS assistors objectively. We hold these recordings

no longer than one week and use them only to measure the quality of assistance.

- We value our customers' opinions. Throughout this year, we will be surveying our customers for their opinions on our service.

Walk-in. You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, grocery stores, copy centers, city and county governments, credit unions, and office supply stores have an extensive collection of products available to print from a CD-ROM or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.

Mail. You can send your order for forms, instructions, and publications to the Distribution Center nearest to you and receive a response within 10 workdays after your request is received. Find the address that applies to your part of the country.

- **Western part of U.S.:**
  Western Area Distribution Center
  Rancho Cordova, CA 95743–0001
- **Central part of U.S.:**
  Central Area Distribution Center
  P.O. Box 8903
  Bloomington, IL 61702–8903
- **Eastern part of U.S. and foreign addresses:**
  Eastern Area Distribution Center
  P.O. Box 85074
  Richmond, VA 23261–5074

CD-ROM. You can order IRS Publication 1796, *Federal Tax Products on CD-ROM,* and obtain:

- Current tax forms, instructions, and publications.
- Prior-year tax forms and instructions.
- Popular tax forms that may be filled in electronically, printed out for submission, and saved for recordkeeping.
- Internal Revenue Bulletins.

The CD-ROM can be purchased from National Technical Information Service (NTIS) by calling **1–877–233–6767** or on the Internet at **www.irs.gov.** The first release is available in mid-December and the final release is available in late January.

IRS Publication 3207, *Small Business Resource Guide,* is an interactive CD-ROM that contains information important to small businesses. It is available in mid-February. You can get one free copy by calling **1–800–829–3676** or visiting the IRS web site at **www.irs.gov.**

Table 1. **Simplified Method Worksheet** (Keep For Your Records)
See the instructions for the worksheet in Part II under *Simplified Method.*

1. Enter the total annuity received this year. Also add this amount to the total for Form 1040, line 16a, or Form 1040A, line 12a . . . . $ ________

2. Enter your cost in the plan at the annuity starting date, plus any death benefit exclusion ________

NOTE: *If your annuity starting date was* ***before this year*** *and you completed this worksheet last year, skip line 3 and enter the amount from line 4 of last year's worksheet on line 4 below. Otherwise, go to line 3.*

3. Enter the appropriate number from Table 1 below. **But** if your annuity starting date was **after** 1997 **and** the payments are for your life and that of your beneficiary, enter the appropriate number from Table 2 below . . . . ________

4. Divide line 2 by line 3 . . . . ________

5. Multiply line 4 by the number of months for which this year's payments were made. If your annuity starting date was before 1987, enter this amount on line 8 below and skip lines 6, 7, 10, and 11. Otherwise go to line 6 . . . . ________

6. Enter any amounts previously recovered tax free in years after 1986 . . . . ________

7. Subtract line 6 from line 2 . . . . ________

8. Enter the smaller of line 5 or line 7 . . . . ________

9. **Taxable annuity for year.** Subtract line 8 from line 1. Enter the result, but not less than zero. Also add this amount to the total for Form 1040, line 16b, or Form 1040A, line 12b. If your Form CSA 1099R or Form CSF 1099R shows a larger amount, use the amount on this line instead . . . . $ ________

10. Add lines 6 and 8 . . . . ________

11. **Balance of cost to be recovered.** Subtract line 10 from line 2 . . . . $ ________

Table 1 for Line 3 Above

IF the age at annuity starting date was. . .	AND your annuity starting date was— **before** November 19, 1996, enter on line 3. . .	**after** November 18, 1996, enter on line 3. . .
55 or under	300	360
56–60	260	310
61–65	240	260
66–70	170	210
71 or older	120	160

Table 2 for Line 3 Above

IF the combined ages at annuity starting date were. . .	THEN enter on line 3. . .
110 and under	410
111–120	360
121–130	310
131–140	260
141 or older	210

Table 2. **Worksheet for Lump-Sum Payment** (Keep For Your Records)
See the instructions for the worksheet in Part II under *Alternative Annuity Option.*

1.	Enter your lump-sum credit (your cost in the plan at the annuity starting date) . . .	$ ______
2.	Enter the present value of your annuity contract	______
3.	Divide line 1 by line 2	______
4.	**Tax-free amount.** Multiply line 1 by the number on line 3. (*Caution: Do not include this amount on line 6 of Table 1 in this publication.*)	______
5.	**Taxable amount (net cost in the plan).** Subtract line 4 from line 1. Include this amount in the total on line 16b of Form 1040 or line 12b of Form 1040A. Also, enter this amount on line 2 of Table 1 in this publication	______

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