



# Important Tax Information About TSP In-Service Withdrawal Payments

Under the Internal Revenue Code (IRC), distributions from your Thrift Savings Plan (TSP) account are taxable income to you for Federal income tax purposes in the year in which payment is made. This notice summarizes the tax rules that apply to TSP in-service withdrawal payments: age-based (age 59 1/2 or older) and financial hardship. Read this notice carefully. Because the tax rules are complex, you may wish to consult a tax advisor.

## 1. Tax Withholding

By law, TSP in-service withdrawal payments are considered **eligible rollover distributions**, and the following Federal income tax withholding rules apply. (The TSP does not withhold state or local income tax.)

- Tax withholding on all eligible rollover distributions of \$200 or more paid in a single year is 20%. **The 20% withholding cannot be waived.** The 20% is tax withholding, not actual tax due. You may be entitled to a refund of a portion of this amount, when you file your annual Federal income tax return.
- Before you receive an eligible rollover distribution, you can avoid withholding on all or any portion of your payment by asking the TSP to transfer that amount to an Individual Retirement Arrangement (IRA) or other eligible retirement plan. (See Section 2.)
- You may elect to have an amount withheld in addition to the 20% withholding by completing Line 3 on IRS Form W-4P, Withholding Certificate for Pension or Annuity Payments, and submitting it to the TSP Service Office along with your in-service withdrawal request. Line 1 and Line 2 are not valid entries for this type of payment.

## 2. Transferring or Rolling Over Your In-Service Withdrawal

All or any part of your in-service withdrawal can either be transferred or rolled over to an IRA or other eligible retirement plan. This permits you to postpone paying tax on that amount until you withdraw the money from the IRA or plan.

A **transfer** occurs when you instruct the TSP to send all or part of your distribution directly to an IRA or other eligible retirement plan instead of issuing it to you. The mandatory 20% Federal income tax withholding does not apply to an amount that the TSP transfers directly to an IRA or other eligible retirement plan; **however it does apply to any payment made directly to you, even if you then roll it over.**

A **rollover** occurs when the TSP makes a distribution to you (which includes the amount of the check you receive plus the amount withheld) and you deposit any part of that payment into an IRA or other eligible retirement plan within 60 days of the date you receive it. You must pay Federal income tax on any part of the distribution that you do not roll over, including any amount withheld -- even if you roll over the amount you receive -- unless you deposit personal funds into your IRA or other plan equal to the amount withheld. (If you do this, you may receive a refund of the amount withheld, but you cannot wait until you receive the refund to complete the rollover.)

You may transfer or roll over your payment into an eligible retirement plan. This can be either an Individual Retirement Account or an Individual Retirement Annuity (other than an endowment contract); a qualified pension, profit-sharing, or stock bonus plan; or an annuity plan described in section 403(a) of the IRC. However, you cannot transfer or roll over your payment into a "Roth" IRA (which became available January 1, 1998).

If you want to roll your distribution into the qualified plan of another employer at a later date, you should instruct the financial institution to establish a "conduit" Individual Retirement Account for you. A conduit account can only contain amounts that have been transferred or rolled over. It cannot contain regular (i.e., deductible or nondeductible) contributions; Individual Retirement Accounts containing regular contributions cannot be rolled over into a plan maintained by another employer.

## 3. Tax Reporting

The TSP will report your in-service withdrawal to the Internal Revenue Service, including the payment that is made directly to you and all transfers to IRAs or

other eligible retirement plans. The TSP will also report the distribution to the state in which your TSP account record shows you resided at the time payment was made, if that state imposes an income tax.

In January of the year that follows your payment, the TSP will send you Form 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. Be sure your agency keeps your TSP account address up to date so that you receive the form and other important information about your account.

You should include the amount reported on Form 1099-R as income in your individual income tax return for the year in which payment was made. However, you should then exclude from adjusted gross income amounts that are transferred or rolled over. Attach a copy of Form 1099-R to your Federal tax return.

#### 4. Early Withdrawal Penalty Tax

Under the IRC, an early withdrawal penalty tax of 10% is imposed on any in-service withdrawal payment that you receive directly from the TSP (including any tax withholding) **before you become age 59 1/2**. Thus, if you request a financial hardship withdrawal and are under age 59 1/2, the penalty tax will apply to you. The penalty tax is in addition to the ordinary income tax that you pay on TSP payments.

The early withdrawal penalty does not apply if you are age 59 1/2 or older. It does not apply to amounts that you transfer or roll over to an IRA or other plan, regardless of your age, but it will apply to payments that you receive from the IRA or plan before age 59 1/2.

#### 5. Five-Year or 10-Year Tax Option

If you do not transfer or roll over all or any part of your distribution, you may be able to lower the income tax you pay on your in-service withdrawal by using the **5-year or 10-year tax option**. You can use this tax option **only if** your entire account balance, determined as of the date of distribution, is paid to you in one tax year. The type of payment is referred to as an **eligible lump sum distribution**.

At present, if you use the **5-year tax option**, your payment is taxed as if it were paid to you over five tax years, using the tax rates for single taxpayers in effect in the year payment is made. The 5-year tax option is available if you are at least age 59 1/2 at the time you receive your distribution, or were age 50

before January 1, 1986. (In 1996, Congress eliminated the 5-year tax option for tax years beginning after December 31, 1999.)

With **10-year tax option**, your payment is taxed as if it were paid to you over 10 tax years, but you must use the tax rates in effect in 1986. The 10-year tax option is available only if you attained age 50 before January 1, 1986.

The following rules apply to either type of tax option:

To qualify for either tax option, you must have been an active participant in the TSP for at least five years before the year in which your distribution is made. You are considered an active participant if a contribution was made to your TSP account by either you or your agency during a year.

If you decide to use the 5-year or 10-year tax option for your TSP distribution, you must also use it for any eligible lump sum distribution which you receive in the same tax year. This includes a withdrawal of your entire account after separation or a taxable loan distribution. It also includes an eligible lump sum distribution from any other plan maintained by an employer (but excludes such distributions from IRAs).

You can use the tax option only once in your lifetime. This means that if you use it in one tax year, you cannot use it for a distribution received from the TSP or another plan in any subsequent year.

You can elect either 5-year or 10-year tax option by filing IRS Form 4972, Tax on Lump Sum Distributions, with your annual income tax return.

#### 6. Excise Tax on Excess Distributions

In 1997, Congress repealed the 15% excise tax on "excess distributions" made after December 31, 1996.

#### 7. TSP Service Office Information

If you have any questions regarding this notice, please contact the TSP Service Office at (504) 255-6000 (TDD: (504) 255-5113) or write to:

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