

# Bankruptcy Information

Petitions filed before October 17, 2005

This fact sheet explains how a bankruptcy petition filed before October 17, 2005, affects a Thrift Savings Plan (TSP) account, loan, or in-service withdrawal. (For bankruptcy petitions filed *on or after* October 17, 2005, refer to the Bankruptcy Information — Petitions filed on or after October 17, 2005 fact sheet.)

## ***How are funds in my TSP account affected by a bankruptcy?***

The TSP is a retirement savings plan for Federal employees and members of the uniformed services. It is similar to retirement plans authorized under section 401(k) of the Internal Revenue Code. (See 5 U.S.C. §§ 8351, 8401-79.)

The funds in your account are held in trust for you by the TSP and are protected from the claims of creditors by a law which provides that the funds “may not be assigned or alienated and are not subject to execution, levy, attachment, garnishment, or other legal process.” (See 5 U.S.C. §§ 8437(e)(g).) This provision is enforceable in a bankruptcy action by virtue of 11 U.S.C. § 541(c)(2). Consequently, your TSP account cannot be made a part of your bankruptcy estate.

## ***Is my TSP loan a debt?***

No. Your TSP loan is not a debt because you are borrowing your own money and repaying it to your TSP account. The TSP is not your creditor.

## ***Can my TSP loan be discharged in bankruptcy?***

No. Your TSP loan cannot be discharged in bankruptcy because it is not a debt.

## ***Must I stop my TSP loan payments when I file for bankruptcy?***

The answer to this question depends on whether you file an action under chapter 7 or chapter 13 of the Bankruptcy Code.

A chapter 7 bankruptcy action will not affect your obligation to repay a TSP loan. Therefore, under a chapter 7 bankruptcy, you must continue making loan payments as provided in your Loan Agreement. This is because a TSP loan is not a debt and the TSP is not your creditor, so the bankruptcy court does not have jurisdiction over your TSP loan.

However, if you file a chapter 13 bankruptcy action, you must instruct your employing agency or service to stop your loan payments unless the bankruptcy court expressly permits them to continue. This is because in a chapter 13 bankruptcy, the bankruptcy court has jurisdiction over your income, and your agency or service may not deduct loan payments from your pay without court approval.

Your employing agency or service is responsible for stopping your payroll deductions for loan payments when it learns that you have filed a chapter 13 bankruptcy action. Therefore, you should give notice to your agency or service if you file for a chapter 13 bankruptcy and you have a TSP loan. Do not contact the TSP to stop your loan payments; only your agency or service can process such a request.

## ***What will happen to my account if I must stop my TSP loan payments because I file for bankruptcy?***

When you borrow from your TSP account, you agree to repay the money to your account, with interest, by making regularly scheduled loan payments through payroll deductions. (See 5 U.S.C. § 8433(g); 5 C.F.R. part 1655.)

If you stop making loan payments for any reason other than approved nonpay status, the TSP will send you a notice explaining how to bring your loan payments



# Fact Sheet

OC 95-10A (5/2012)  
Previous Editions Obsolete

up-to-date. If you do not (or, as in the case of a chapter 13 bankruptcy, are not permitted to) bring your loan payments up-to-date, the TSP will close your loan and report the unpaid loan balance to the Internal Revenue Service (IRS) as a taxable distribution to you. Besides having to pay income taxes on the taxable amount of the distribution, you may be subject to a 10% IRS early withdrawal penalty.

**Special note about tax-exempt and Roth contributions:** If any portion of your outstanding loan balance contains tax-exempt or Roth contributions, those contributions will **not** be subject to Federal income tax or the 10% early withdrawal penalty tax. However, you **will** have to pay taxes on the **earnings** on tax-exempt contributions that were part of your traditional balance. Also, as long as you are still employed by the Federal Government, or still an active member of the uniformed services, any **Roth earnings** included in the distribution **will be** subject to Federal income tax, even if you have already met the conditions necessary for your Roth earnings to be qualified.\*

Once a TSP loan is closed, it cannot be reopened, and the outstanding balance cannot be returned to the TSP. In addition, you cannot apply for another TSP loan for 12 months from the date a taxable distribution is declared.

### ***Can I temporarily suspend loan payments during my bankruptcy action?***

No. The IRS requires the TSP to close a loan and issue a taxable distribution if payments do not continue under the terms of the Loan Agreement.

### ***What if the bankruptcy court allows me to repay my loan?***

If your employing agency or service has stopped your loan payments, you should immediately instruct it in writing to resume deducting your loan payments. You must provide the agency or service with documentation that allows it to determine that you are permitted to have your loan payments continue. By the end of the next calendar quarter, you will also have to make up any payments you missed out of your personal funds. Information about

\* Roth earnings become qualified (i.e., paid tax-free) when the following **two** conditions have been met: (1) 5 years have passed since January 1 of the calendar year in which you made your first Roth contribution, **and** (2) you have reached age 59½, have a permanent disability, or have died. **Note:** The TSP cannot certify to the IRS that you meet the Internal Revenue Code's definition of disability when your taxes are reported. Therefore, you must provide the justification to the IRS when you file your taxes.

making up missed payments is available on the TSP website ([www.tsp.gov](http://www.tsp.gov)). You can also call the TSP at 1-877-968-3778 (TDD: 1-877-847-4385) or, outside the U.S. and Canada, at 404-233-4400.

Please note, however, that your loan payments can only resume if the TSP has not yet closed your loan.

### ***Can the bankruptcy court change the terms of my TSP Loan Agreement?***

No. Because your TSP loan is not a debt and the TSP is not your creditor, the bankruptcy court does not have jurisdiction over your TSP loan. Therefore, the bankruptcy court cannot change the timing or the amount of your loan payments or require the TSP to accept loan payments through your chapter 13 plan.

However, if your loan is in good standing, you can ask the TSP if you are eligible to reamortize your loan to change your payment amount or to shorten or lengthen your loan term within the loan's maximum term limit.

### ***Can I obtain a financial hardship in-service withdrawal during my bankruptcy action?***

The answer to this question depends on whether you file for bankruptcy under chapter 7 or chapter 13 of the Bankruptcy Code.

A chapter 7 bankruptcy action does not affect your ability to obtain a financial hardship in-service withdrawal.

However, a participant who is a debtor in a chapter 13 bankruptcy action is not eligible for a financial hardship in-service withdrawal based on negative net monthly cash flow. This is because such a withdrawal is only available to a participant who demonstrates that his or her net monthly income is insufficient to pay ordinary monthly household expenses. In a chapter 13 bankruptcy action, the bankruptcy court will ensure that the debtor has sufficient funds to pay living expenses.

However, if you are in a chapter 13 action, you may be eligible for a financial hardship in-service withdrawal if you have unpaid medical expenses, a casualty loss, or unpaid legal fees incurred for a separation or a divorce. (See Form TSP-76, Financial Hardship In-Service Withdrawal Request.)