Recap: AFSA Presentation on "Everything You Need to Know About TSP," October 6, 2016

On October 6, AFSA hosted its 11th Federal Benefits Speaker Series Programs with a repeat presentation by Randy Urban, a TSP Training and Liaison Specialist with the Federal Retirement Thrift Investment Board (FRTIB), who had spoken to AFSA in 2013. The room was packed, with close to a hundred. Most AFSA members are well aware that TSP is an incredible deal for federal employees: good portfolio diversification, easy, convenient reallocation of contributions, and extremely low management fees: $0.29/$1,000, a fraction of the $4.60/$1,000 average for 401K plans. How much of a difference does that management fee make? At an annual 6% rate of return, $50,000 grows to $284,827 in TSP but only $252,048 in an average 401K after 30 years.

Maxing the TSP Nest Egg but How to Withdraw? With such a low management fee, it's not surprising that not a few Foreign Service employees have committed to making the maximum annual contribution (currently $18,000/year and an additional $6,000 "catch up" for those 50 and over) to build up some pretty nice nest eggs. But in retirement, or as retirement approaches, focus shifts to withdrawal strategies, as reflected by a very robust discussion of TSP withdrawal options earlier this year on the Online AFSA Community. And that is why AFSA asked FRTIB's Randy Urban back, to present a TSP Pre-Separation Workshop, to help AFSA members understand and assess their withdrawal options.

TSP Planning and Tools. Mr. Urban began by presenting TSP as one of the three pillars of an annuitant's financial security in retirement, along with one's pension and Social Security. He introduced the "How Much Should I Save," calculator under "Planning and Tools" on the www.tsp.gov website, reminding attendees of the benefit of contributing at least 5% of one's salary, to get the full 4% government match. If contributing the $18,000 maximum, one should divide it fairly evenly across all 26 pay periods; otherwise, one risks losing the 4% government match for every pay period after the maximum contribution is reached.

Withdrawals before and after Separation. One does not have to separate or retire to make a withdrawal from TSP, but will be subject to a 10% early withdrawal penalty if under the age 59½ (unless an exception applies). TSP participants 59½ or older may take an Age-based withdrawal -- a one-time only lump sum TSP withdrawal while still in service – without an early withdrawal penalty. If one makes an age-based withdrawal, one is not then eligible to make a partial withdrawal from the same account after separating from the service. There is no requirement to close a TSP account on retirement or separation; participants can keep their TSP accounts as long as they like, enjoying those low management fees, with a range of withdrawal options. Before separating, participants should be sure their personal data on file with TSP is correct and report any errors to their own agency, for correction. They can settle any TSP loan within 90 days of separation, pay it down and re-amortize. At the end of the 90-day TSP grace period, TSP will declare a taxable distribution on any unpaid balance.

Transfers/Rollovers between TSP, IRA's and 401K's. To take advantage of TSP's low management fees, TSP account holders can transfer (also called "direct rollover") or rollover (also called "60 day or indirect rollover") a traditional IRA or a traditional 401(k), traditional 403(b) or traditional 457(b) into the traditional TSP. They can also rollover or transfer a Roth 401K, Roth 401(b) or Roth 457(b) into a Roth TSP. But they cannot transfer or rollover a Roth IRA, Education IRA or Inherited IRA into the TSP. A transfer ("direct rollover") from a traditional IRA or traditional 401(k)/403(b)/457(b) to the TSP is the surest way to avoid taxes in the process. In an indirect rollover (or 60-day rollover), the participant has access to the funds for 60 days. But if the rollover is not properly executed during the 60-day period, withholding taxes and/or penalties could be incurred. Upon separation, participants with both civilian and uniformed TSP accounts can combine them.

TSP Withdrawal Options after Retirement. In retirement, after separation, one can no longer contribute to one's TSP. At retirement, one has a range of withdrawal options: partial, full or a custom mix of withdrawal options. A partial withdrawal is a one-time only lump sum withdrawal and cannot be taken if one had previously taken an age-based in-service withdrawal. Among full withdrawal options, one can opt for a lump-sum withdrawal (20% will be withheld to cover Federal income tax), monthly payments, either by a fixed amount each month or by a monthly payment based on life expectancy, or purchasing an annuity.

Fixed Monthly Payments or Monthly Payments based on Life Expectancy. If one selects a fixed dollar monthly payment, one can adjust that amount annually. Monthly payments continue until the TSP is depleted. Or, one can elect monthly payments based on IRS life expectancy tables, in which case TSP recalculates the amount of one's monthly payment each year, on the anniversary of one's first monthly payment. Payments can decrease in later years as the remaining TSP balance is annually spread over each year's re-estimated life expectancy. If receiving monthly payments based on life expectancy, one can switch to fixed monthly payments one time only. But one can't switch from monthly payments based on a fixed dollar amount to monthly payments based on life expectancy. Each year, from Oct. 1 to Dec. 15, one can file a TSP-73 to change from life expectancy to fixed dollar payments (a one-time-only option) or to change the amount of the fixed monthly payment. In either case, the money is still in one's own TSP account and one can make active investment decisions, including two unrestricted inter-fund transfers per month. A TSP-79 allows one to switch from monthly payments to a final single payment.

A TSP Life Annuity Guarantees an Income Stream for Life. Another full withdrawal option is to purchase a TSP life annuity, which provides for a lifetime income stream, by purchasing an annuity with MetLife. Once funds are transferred to the annuity provider, they are "locked in" and cannot be changed. The TSP life annuity offers a range of options: single life (no survivor benefit) or a 50% or 100% survivor benefit for a joint life with spouse or a joint life with another survivor. Payments can be level or, in some cases, increasing. Participants can choose between a couple of different options for structuring a survivor benefit.

The Mixed Withdrawal Option. Form TSP-70 allows one to make one's withdrawal election. If one wishes, one can allocate a percentage for a single lump-sum payment, a percentage for a Life Annuity (minimum amount is $3500) and a percentage for TSP Monthly payments (either fixed or "life expectancy"); the percentages must add to 100%. Once that withdrawal election is made, one cannot later reallocate fixed monthly payments to a life annuity.

Doing Nothing Until Reaching 70½. But if one doesn't need the income immediately, one can also just leave one's savings in one's TSP account and "do nothing." One can no longer make any contributions (although one can make transfers from qualified employer plans or traditional IRA's to benefit from TSP's low management fees). But one can't "do nothing" forever. By April 1st of the year after one turns 70½, provided one is separated from service, you must take one's "Required Minimum Distribution"

(RMD). That minimum amount is calculated by TSP and recalculated each year, using the IRS Uniform Lifetime Table to estimate the account holder's life expectancy. Failure to take one's RMD can incur a 50% penalty of the RMD for that year. TSP will automatically send a check for the RMD on March 1st of the year one has turned 70½. But after that, the TSP participant is responsible for withdrawing on his or her own by submitting a TSP 70. TSP will withhold 10% of the RMD payment for federal income tax.

TSP Withdrawal Mechanics. Mr. Urban advised that TSP participants should not submit withdrawal forms until officially separated and the separation code has been received by the TSP. Notarized spouse signatures are required for most withdrawal options. In cases where participants also have a Roth TSP balance in their TSP account, withdrawals will always be prorated, with 20% withheld for federal income tax on the taxable portion. Also, one can only transfer or rollover funds from TSP to IRA's or qualified employer plans (like 401(k)'s). One cannot transfer from a TSP directly to a charity; to enjoy the tax free benefit of a Qualified Charitable Distribution (QCD), one must first transfer to an IRA and then make the QCD from there. QCD's count as part of the RMD but are not taxed as income.

Leaving One's TSP to Survivors. Finally, the death benefit for one's TSP is based on one's designation in Form TSP-3, Designation of Beneficiary. The TSP-3 supersedes everything, including a will, which is why it is so critical to revise it whenever there are changes in one's beneficiary situation (e.g. divorce, remarriage, births and deaths, etc.). If there is no TSP-3, the statutory order of precedence is spouse, natural & adopted children, parents, estate and next of kin. A surviving spouse automatically inherits a Beneficiary Participant Account (BPA) upon notification of the death of the TSP participant, automatically invested in the surviving spouse's age-appropriate L Fund until they take over management by completing inter-fund transfers. The spouse then enjoys the same investment and withdrawal options as separated BPA participants. The deceased spouse's RMD from the BPA is calculated based on deceased spouse's age. Payments to non-spouse beneficiaries are subject to 20% tax withholding unless transferred to an inherited IRA account, which allows them to take the Internal Revenue Code (IRC) minimum required distribution amount based on their age.

See the TSP Presentation and Visit www.tsp.gov. Mr. Urban took questions throughout his over 2-hour workshop and then stayed to answer questions for an additional 40 minutes. Because of the amount and complex nature of much of the material, he brought a number of brochures for reference, information which is also available on www.tsp.gov, along with all the forms and procedures they will need to manage their TSP accounts. Feel free to contact AFSA's retiree counselor at retiree@afsa.org or 202-944-5509.